McKinsey&Company

MCKINSEY GLOBAL INSTITUTE

LIONS ON THE MOVE II: REALIZING THE POTENTIAL OF AFRICA'S ECONOMIES

SEPTEMBER 2016

EXECUTIVE SUMMARY

MCKINSEY GLOBAL INSTITUTE

CELEBRATING 25 YEARS OF INSIGHT

25

MCKINSEY GLOBAL INSTITUTE

In the 25 years since its founding, the McKinsey Global Institute (MGI) has sought to develop a deeper understanding of the evolving global economy. As the business and economics research arm of McKinsey & Company, MGI aims to provide leaders in the commercial, public, and social sectors with the facts and insights on which to base management and policy decisions. The Lauder Institute at the University of Pennsylvania ranked MGI the world's number-one private-sector think tank in its 2015 Global Think Tank Index.

MGI research combines the disciplines of economics and management, employing the analytical tools of economics with the insights of business leaders. Our "micro-to-macro" methodology examines microeconomic industry trends to better understand the broad macroeconomic forces affecting business strategy and public policy. MGI's in-depth reports have covered more than 20 countries and 30 industries. Current research focuses on six themes: productivity and growth, natural resources, labor markets, the evolution of global financial markets, the economic impact of technology and innovation, and urbanization.

Recent reports have assessed the economic benefits of tackling gender inequality, a new era of global competition, Chinese innovation, and digital globalization. MGI is led by four McKinsey & Company senior partners: Jacques Bughin, James Manyika, Jonathan Woetzel, and Eric Labaye, MGI's chairman. Michael Chui, Susan Lund, Anu Madgavkar, and Jaana Remes serve as MGI partners. Project teams are led by the MGI partners and a group of senior fellows, and include consultants from McKinsey offices around the world. These teams draw on McKinsey's global network of partners and industry and management experts. Input is provided by the MGI Council, which co-leads projects and provides guidance; members are Andres Cadena, Richard Dobbs, Katy George, Rajat Gupta, Eric Hazan, Acha Leke, Scott Nyquist, Gary Pinkus, Shirish Sankhe, Oliver Tonby, and Eckart Windhagen. In addition, leading economists, including Nobel laureates, act as research advisers.

The partners of McKinsey fund MGI's research; it is not commissioned by any business, government, or other institution. For further information about MGI and to download reports, please visit **www.mckinsey.com/mgi**.

Copyright © McKinsey & Company 2016

LIONS ON THE MOVE II: REALIZING THE POTENTIAL OF AFRICA'S ECONOMIES

SEPTEMBER 2016

Jacques Bughin | Brussels
Mutsa Chironga | Johannesburg
Georges Desvaux | Johannesburg
Tenbite Ermias | Nairobi
Paul Jacobson | Johannesburg
Omid Kassiri | Nairobi
Acha Leke | Johannesburg
Susan Lund | Washington, DC
Arend Van Wamelen | Johannesburg
Yassir Zouaoui | Casablanca

IN BRIEF

LIONS ON THE MOVE II

Many people are questioning whether Africa's economic advances are running out of steam. Five years ago, growth was accelerating in almost all of the region's diverse economies, but recently their paths have diverged. Some countries have continued to grow fast while others have experienced a marked slowdown as a result of lower resource prices and higher sociopolitical instability. Despite this, the continent's fundamentals remain strong, but African governments and companies will need to work harder to make the most of its potential.

- Africa's real GDP grew at an average of 3.3 percent a year between 2010 and 2015, considerably slower than the 5.4 percent from 2000 to 2010. However, this average disguises stark divergence. Growth slowed sharply among oil exporters and North African countries affected by the 2011 Arab Spring democracy movements. The rest of Africa posted accelerating growth at an average annual rate of 4.4 percent in 2010 to 2015, compared with 4.1 percent in 2000 to 2010. Africa as a whole is projected by the International Monetary Fund to be the world's second-fastest-growing economy to 2020.
- The region has robust long-term economic fundamentals. In an aging world, Africa has the advantage of a young and growing population and will soon have the fastest urbanization rate in the world. By 2034, the region is expected to have a larger workforce than either China or India—and, so far, job creation is outpacing growth in the labor force. Accelerating technological change is unlocking new opportunities for consumers and businesses, and Africa still has abundant resources.
- Spending by consumers and businesses today totals $4 trillion. Household consumption is expected to grow at 3.8 percent a year to 2025 to reach $2.1 trillion. Business spending is expected to grow from $2.6 trillion in 2015 to $3.5 trillion by 2025. Tapping consumer markets will require companies to have a detailed understanding of income, geographic, and category trends. Thriving in business markets will require them to offer products and develop sales forces able to target the relatively fragmented private sector.
- Africa could nearly double its manufacturing output from $500 billion today to $930 billion in 2025, provided countries take decisive action to create an improved environment for manufacturers. Three-quarters of the potential could come from Africa-based companies meeting domestic demand (today, Africa imports one-third of the food, beverages, and similar processed goods it consumes). The other one-quarter could come from more exports. The rewards of accelerated industrialization would include a step change in productivity and the creation of six million to 14 million stable jobs over the next decade.
- Corporate Africa needs to step up its performance to make the most of these opportunities. The continent has 400 companies with revenue of more than $1 billion per year, and these companies are growing faster, and are more profitable in general than their global peers. Yet Africa has only 60 percent of the number of large firms one would expect if it were on a par with peer regions—and their average revenue, at $2 billion a year, is half that of large firms in Brazil, India, Mexico, and Russia, for instance.[1] No Africa-owned company is in the Fortune 500. Companies looking to grow across the continent should develop a strong position in their home market, use that as a base for expanding into markets well beyond their immediate region, adopt a long-term perspective and build the partnerships needed to sustain success over decades, and be ready to integrate what would usually be outsourced. They should look for opportunities in six sectors that MGI finds have "white space"—wholesale and retail, food and agri-processing, health care, financial services, light manufacturing, and construction—with high growth, high profitability, and low consolidation, and invest in building and retaining talent.
- Governments will have to play a stronger role in unleashing renewed dynamism. Six priorities emerge from this research: mobilize more domestic resources, aggressively diversify economies, accelerate infrastructure development, deepen regional integration, create tomorrow's talent, and ensure healthy urbanization. Delivering on these six priorities will require the vision and determination to drive far-reaching reforms in many areas of public life—and capable public administration with the skill and commitment to implement such reforms.

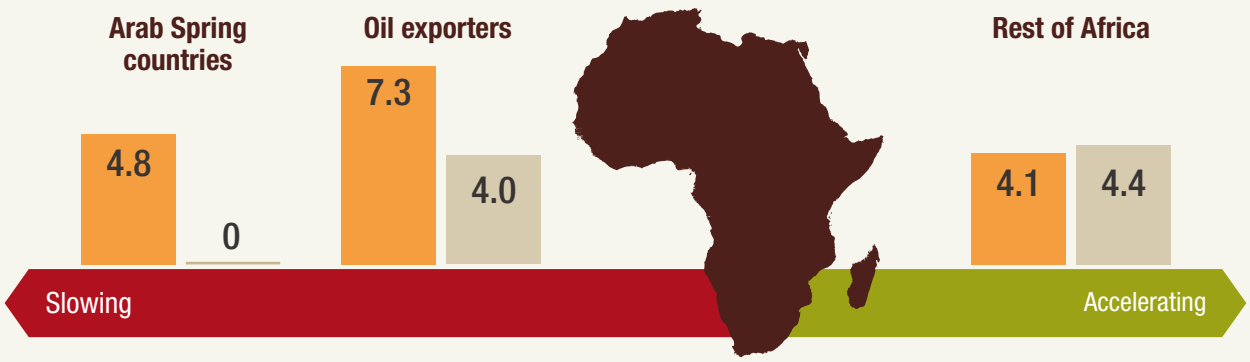
Download the full report at **www.mckinsey.com/mgi**

[1] Excluding South African companies.

LIONS ON THE MOVE
Realizing Africa's potential

Africa's growth path is diverging

Real compound annual growth rate, %



$5.6 trillion

in **African business opportunities** by 2025

$2.1 trillion
Household consumption

$3.5 trillion
of B2B spending[1]

Manufacturing output
can **double** by 2025

Africa needs more large companies to power growth

400 African companies with annual revenue exceeding **$1 billion**

African companies **grow faster** and are **more profitable** than global peers...

0 ...but there are **zero** African companies in the Fortune 500

Government imperatives

Mobilize domestic resources	Aggressively diversify economies	Accelerate infrastructure development	Deepen regional integration	Create tomorrow's talent	Ensure healthy urbanization

Transform public leadership and governance

[1]Business-to-business spending

McKinsey&Company

© Tom Cockrem/Getty images

EXECUTIVE SUMMARY

In 2010, the McKinsey Global Institute's report on the African economy—*Lions on the move: The progress and potential of African economies*—highlighted a quickening of Africa's economic pulse and a new commercial vibrancy.[1] Real GDP had grown at 4.9 percent a year between 2000 and 2008, more than twice its pace in the 1980s and 1990s, making Africa one of the most rapidly growing regional economies in the world. With growth in 27 of the 30 largest economies accelerating compared with the previous decade, Africa was clearly on the rise. But six years on, growth has slowed significantly. Between 2010 and 2015 Africa's overall GDP growth averaged just 3.3 percent. Is Africa's renaissance losing its vigor?

3.3%
average real GDP growth in Africa, 2010–15

There is no doubt that the region's overall growth performance has been dragged down in recent years by a sharp slowdown in particular economies. The economies of Egypt, Libya, and Tunisia were badly affected by the political turmoil of the Arab Spring, and Africa's oil exporters were left vulnerable to the decline in oil prices. However, the rest of Africa continues to enjoy strong growth; the African story is diverging. Regardless, the fundamentals across the whole continent are strong, and long-term growth projections are good. The region is expected to enjoy the fastest urbanization of any region in the world, and to have a larger workforce than either India or China by 2034. It also has a huge opportunity to leverage internet and mobile technology, and still has abundant resources.

The region is expected to enjoy the fastest urbanization of any region in the world.

Despite recent shocks and challenges, Africa's household consumption and business spending are both growing strongly, offering companies a $5.6 trillion opportunity by 2025. Africa's manufacturing sector today underperforms those of other emerging economies. However, output could expand to nearly $1 trillion in 2025 if Africa's manufacturers were to produce more to meet domestic demand from consumers and businesses, and work with governments to address factors hindering their ability to produce and export goods.

To achieve this potential will require Africa's companies to step up their performance. Africa is home to 700 companies with revenue of more than $500 million per year, including 400 with revenue above $1 billion. However, the region has a relatively small number of large companies. It needs more. The top 100 African companies have been successful by building a strong position in their home market before expanding, adopting a long-term perspective, integrating what they would usually outsource, targeting high-potential sectors with low levels of consolidation, and investing in building and retaining talent.

Governments will need to address productivity and drive growth by focusing on six priorities emerging from this research: mobilize more domestic resources; aggressively diversify economies; accelerate infrastructure development; deepen regional integration; create tomorrow's talent; and ensure healthy urbanization. This agenda will require a step change in the quality of African leadership and governance, and active collaboration between the public and private sectors.

[1] *Lions on the move: The progress and potential of African economies*, McKinsey Global Institute, June 2010.

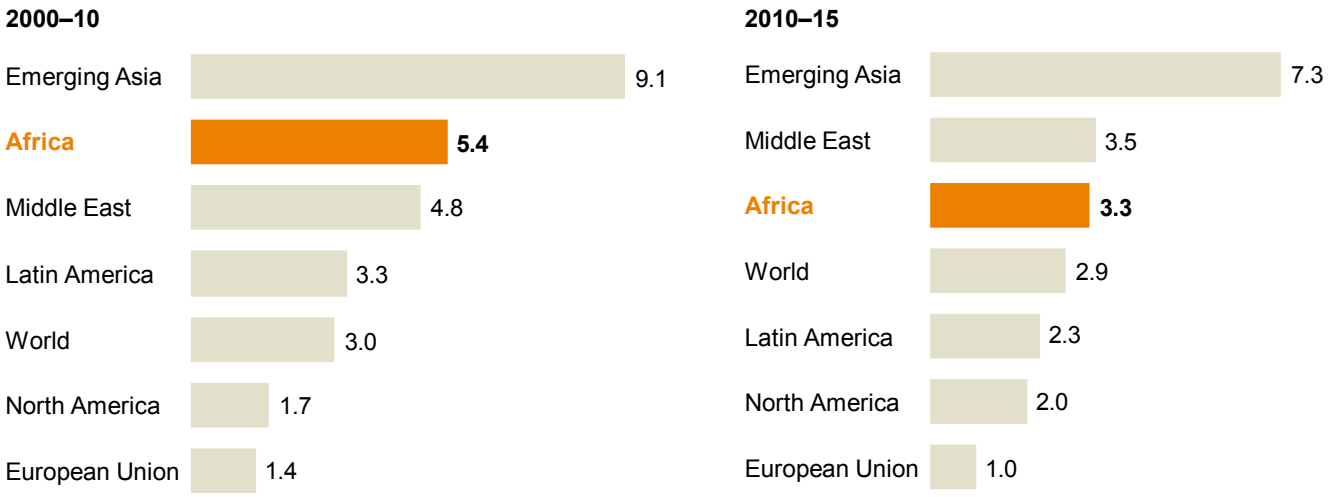
AFRICA'S GROWTH OUTLOOK HAS BECOME MORE NUANCED DUE TO SHOCKS IN PARTS OF THE REGION

Key economic indicators for Africa point to slowing growth—in common with other major emerging markets. Between 2010 and 2015, GDP grew at 3.3 percent a year, sharply slower than the 5.4 percent average annual growth rate between 2000 and 2010 (Exhibit E1).[2] Annual productivity growth also slowed between these two periods, from 2.3 percent in 2000–10 to 0.8 percent in 2010–15. Foreign direct investment (FDI) and other capital flows into Africa have leveled off, a far cry from the period from 2005 to 2010 when such flows had tripled. At the same time, savings have fallen steeply from a peak of 27 percent of GDP in 2005 to 16 percent in 2015. It has become increasingly difficult for African countries to compensate by tapping global debt markets. The continent's average debt-to-GDP ratio rose from 40 percent in 2011 to 50 percent in 2015, still relatively low by global standards. However, sovereign debt yields have risen sharply in many countries. The pan-African average budget deficit in 2015 exceeded 6 percent of GDP.

Exhibit E1

Like other emerging economies, Africa as a whole has experienced a growth slowdown over the past five years

Measured real GDP growth
Compound annual growth rate
%



SOURCE: *World economic outlook: Too slow for too long,* IMF, April 2016; McKinsey Global Institute analysis

However, closer analysis shows that this rather disappointing combination of indicators tells a misleadingly negative story. The overall slowdown in Africa's growth largely reflects economic deterioration in two distinct groups of countries: North African countries caught up in the turmoil that followed the democracy movements collectively known as the Arab Spring, and oil exporters affected by the sharp decline in oil prices. Together these two groups account for nearly three-fifths of Africa's combined GDP (Exhibit E2). As a group, Egypt, Libya, and Tunisia did not grow at all between 2010 and 2015, having grown at an average rate of 4.8 percent over the previous decade.[3] The rate of growth among oil exporters Algeria, Angola, Nigeria, and Sudan fell sharply from 7.3 percent to 4.0 percent between the two periods. Productivity growth also declined in these two groups of economies, from 1.1 percent to 0.3 percent in the Arab Spring countries and from 3.9 percent to 1.4 percent in Africa's oil exporters.

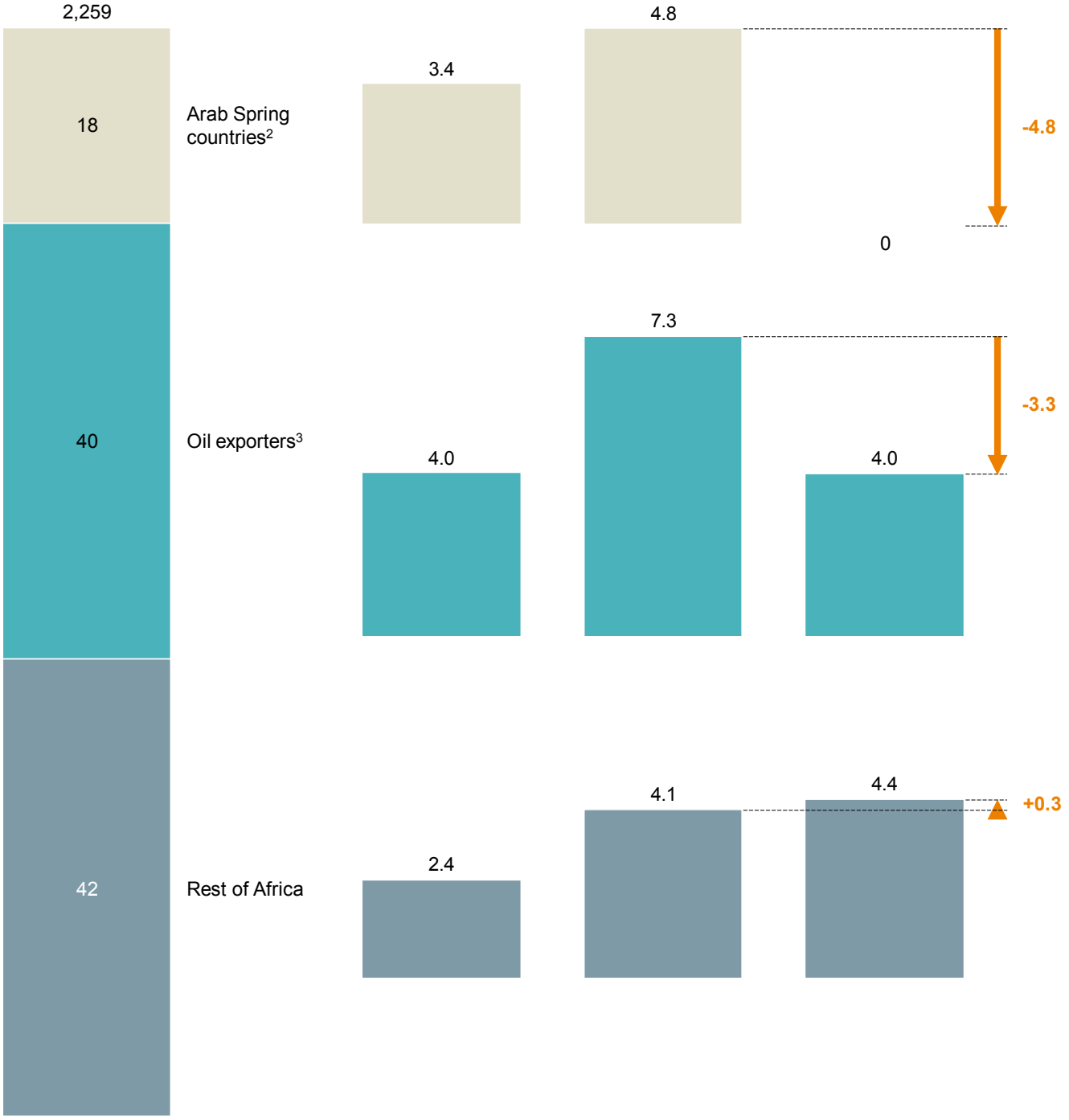
[2] In real prices.

[3] Egypt and Tunisia experienced slower growth of 2.5 percent and 1.5 percent respectively, while Libya's economy contracted.

Exhibit E2

A sharp growth slowdown in Africa's oil exporters and countries involved in the Arab Spring dragged down the region's average GDP growth

	1990–2000	2000–10	2010–15
Total African GDP growth rate %	3.1	5.4	3.3



1 Includes GDP data for 53 African countries, excluding South Sudan.
2 Egypt, Libya, and Tunisia.
3 Algeria, Angola, Chad, Democratic Republic of Congo, Equatorial Guinea, Gabon, Nigeria, and Sudan.
NOTE: Numbers may not sum due to rounding.

SOURCE: *World economic outlook: Too slow for too long,* IMF, April 2016; McKinsey Global Institute analysis

In the rest of the continent, GDP growth accelerated to an average annual rate of 4.4 percent in 2010–15 from 4.1 percent in 2000–10. Productivity grew at a consistent compound annual rate of 1.3 percent over both periods. Since 2010, GDP growth has accelerated in around half of the largest 30 economies and decelerated in the other half. The decelerating economies include the continent's six largest—Nigeria, Egypt, South Africa, Algeria, Morocco, and Angola—while the accelerating countries include Botswana, Cameroon, Côte d'Ivoire, Democratic Republic of Congo, Ethiopia, Gabon, Ghana, Kenya, Madagascar, Namibia, Senegal, Tanzania, and Zimbabwe.

6
largest African economies have grown more slowly since 2010

This variance is a reminder that Africa is a diverse regional economy and that countries on the continent remain vulnerable to economic, social, and political shocks. To better gauge stability at the country level, MGI has developed an African Stability Index that we hope can help businesses and investors understand their portfolio risk and help policy makers understand and address their own countries' vulnerabilities.[4] The index highlights the diverging growth and stability trends that economies in the region have been experiencing since MGI published its first report on Africa's economies in 2010.[5] Three distinct groups emerge from the index (Exhibit E3).

- **Stable growers.** These countries, which accounted for 19 percent of Africa's GDP in 2015, posted average GDP growth of 5.8 percent a year between 2010 and 2015—higher than the 2.9 percent a year global average over this period—and demonstrated relatively high levels of stability. This group includes Botswana, Côte d'Ivoire, Ethiopia, Kenya, Mauritius, Morocco, Rwanda, Senegal, Tanzania, and Uganda. These countries, typically not dependent on resources for growth, are smaller economies that are progressing with economic reform and increasing their competitiveness.

- **Vulnerable growers.** These countries, which accounted for 35 percent of African GDP in 2015, achieved average GDP growth of 5.1 percent a year over the past five years but had relatively low levels of stability. This group includes countries heavily dependent on resources, such as Nigeria, Angola, and Zambia, as well as countries such as the Democratic Republic of Congo, which have clear potential but need to improve their security, governance, or macroeconomic stability.

- **Slow growers.** These countries, which accounted for 46 percent of Africa's GDP in 2015, together grew at 1.3 percent per year between 2010 and 2015—less than the 2.9 percent a year global average over that period—and have had varying degrees of stability. This group includes the countries affected by the Arab Spring—Libya, Egypt, and Tunisia. It also includes South Africa, which is experiencing slow growth and high unemployment in spite of promising opportunities that could spur development.[6]

[4] The stability component of the index measures three factors, each given equal weighting. The first is the country's macroeconomic stability, which reflects its gross debt-to-GDP ratio and its external balances measured by reserves in months of imports. The second is economic diversification, as measured by resources as a share of exports. The third is social and political stability, which includes unemployment levels, the number of incidents of violence, and the Ibrahim Index of African Governance. Each country's stability ranking is then plotted against its recent historical growth, the compound annual GDP growth rate for 2010 to 2015.

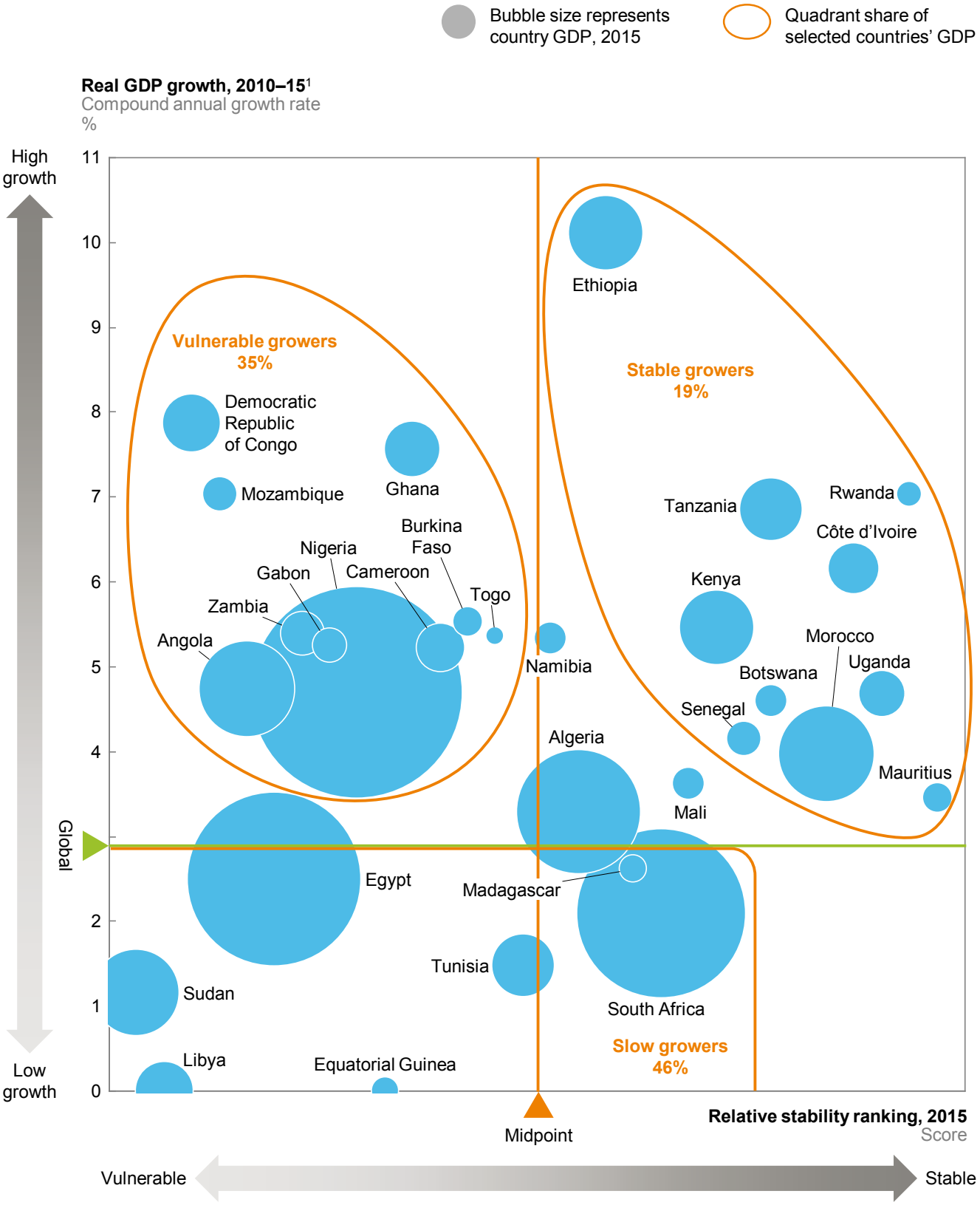
[5] *Lions on the move: The progress and potential of African economies*, McKinsey Global Institute, June 2010.

[6] *South Africa's big five: Bold priorities for inclusive growth*, McKinsey Global Institute, August 2015.

Exhibit E3

Some countries have weathered economic challenges better than others—three divergent groups emerge from MGI's African Stability Index

Comparison of historical GDP growth rates to country stability rankings



1 The index covers 30 economies accounting for 96% of GDP; Equatorial Guinea and Libya are plotted manually because of negative growth rates over this period.

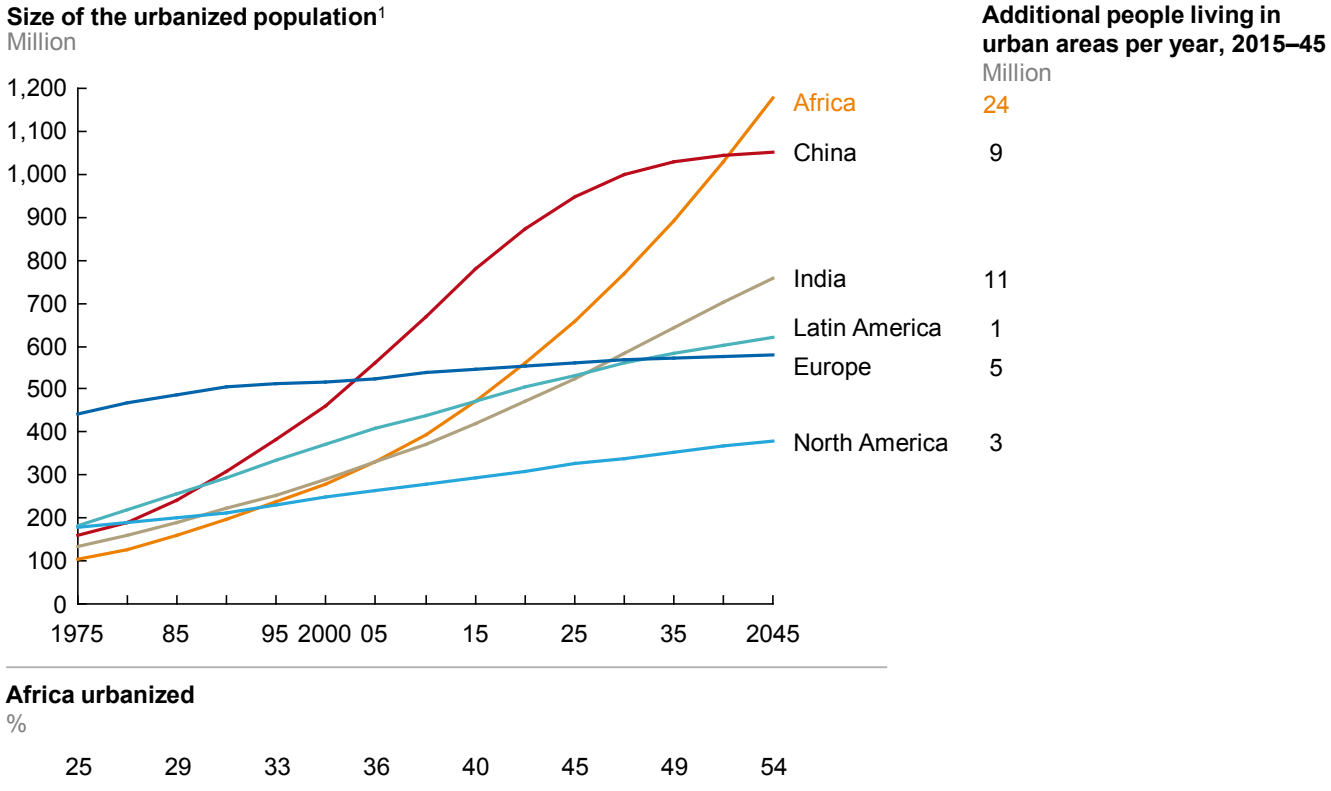
SOURCE: *World economic outlook: Too slow for too long,* IMF, April 2016; McKinsey African Stability Index; McKinsey Global Institute analysis

Despite African economies diverging in their growth paths from 2010 to 2015, the continent's overall outlook remains promising. Africa's collective GDP is still expanding faster than the world average, and it is forecast to accelerate over the next five years to become the world's second-fastest-growing region once again. In the longer term, four factors could have a transformative effect on the continent's economies and their pace of growth.

- **The world's fastest urbanization.** Africa is the world's fastest urbanizing region. Over the next decade, an additional 187 million Africans will live in cities—equivalent to ten cities the size of Cairo, Africa's largest metropolitan area.[7] Between 2015 and 2045, an average of 24 million additional people are projected to live in cities each year, compared with 11 million in India and nine million in China (Exhibit E4). Urbanization has a strong correlation with the rate of real GDP growth, because productivity in cities is more than double that in the countryside: Africa's urban GDP per person was $8,200 in 2015, compared with $3,300 in rural areas.[8] Higher productivity translates into higher incomes, and cities offer better access to infrastructure, education, and new markets, resulting in more rapid growth in consumption by households and businesses. The challenge will be to cope with the stresses of rapid urban expansion, including provision of housing and services.

Exhibit E4

Africa is urbanizing faster than any other region; its cities are expected to gain 24 million people each year until 2045



1 Population living in urban areas. UN forecasts last adjusted in 2014.

SOURCE: World urbanization prospects, June 2014 revision, United Nations population division; McKinsey Global Institute analysis

7 McKinsey Global Institute Cityscope, 2015.

8 MGI estimated this figure by splitting into rural and urban activities sectoral data from the International Labour Organization, *World economic outlook*, IMF, April 2016; United Nations Statistics Division; national statistical offices; and Lars Christian Moller, *Ethiopia's great run: The growth acceleration and how to pace it*, World Bank working paper number 99399, November 2015.

- **A workforce larger than those of either China or India by 2034.** Africa has a young population and a growing labor force—a highly valuable asset in an aging world. The challenge for Africa will be to ensure that its economies continue to create sufficient jobs for the many millions of young people entering the workforce—thus far the signs are positive with the rate at which stable jobs have been created outpacing growth in the workforce—and to help develop their skills. By 2034, the working-age population is expected to be 1.1 billion, larger than that of either China or India. Roughly 60 percent of the world's population lives in countries with fertility rates below replacement rates and, for the first time in human history, demographic change could mean that the planet's population plateaus. In some countries, one-third of the workforce could retire in the period to 2025, with a potentially negative impact on economic growth prospects. However, Africa's demographics are still working in its economic favor: an expanding working-age population is associated with strong rates of GDP growth.

Africa has a young population and a growing labor force—a highly valuable asset in an aging world.

- **Huge potential from accelerating technological change.** The accelerating scope, scale, and economic impact of technology is a major transformative force around the world.[9] Faster penetration of the internet and mobile phones offers Africa a huge opportunity to enhance growth and productivity; Africa's penetration of smartphones is expected to reach 50 percent by 2020, from only 18 percent in 2015.[10] Previous MGI research estimated that the internet could drive 10 percent of Africa's GDP by 2025.[11] This trend is already transforming a number of sectors, including banking, retail, power, health care, and education. Electronic payments are sweeping across the region and changing the business landscape. East Africa is already a global leader in mobile payments. E-commerce in Africa is growing quickly—revenue has doubled in Nigeria each year since 2010. In South Africa, smart metering is taking off and is expected to modernize consumer payments in the power sector, while ambulance services are using mobile application technology to improve response times greatly. The African Leadership University, launched in Mauritius in 2015, is using technology to reduce teaching costs and deliver e-learning, creating a replicable model for expansion across the continent.

- **Continued abundance of resources.** Africa contains 60 percent of the world's unutilized but potentially available cropland, as well as the world's largest reserves of vanadium, diamonds, manganese, phosphate, platinum-group metals, cobalt, aluminum, chromium, and gold. It is responsible for 10 percent of global exports of oil and gas, 9 percent of copper, and 5 percent of iron ore. Even at recent low prices for such commodities, a significant share of African production continues to be cost-competitive, putting the resources sector in a strong position for when demand—and, eventually investment—recover.[12] Capturing these opportunities will be challenging. Governments will need to improve their investment attractiveness in a weaker environment, while companies must review their approach to community engagement so that they have the support of local communities as well as their "license to operate" from regulators.

9 See Richard Dobbs, James Manyika, and Jonathan Woetzel, *No ordinary disruption: The four forces breaking all the trends*, PublicAffairs, 2015.

10 Estimated by MGI using forecasts from *The mobile economy: Sub-Saharan Africa 2015*, GSMA, 2015; UN Population Division.

11 *Lions go digital: The internet's transformative potential in Africa*, McKinsey Global Institute, November 2013.

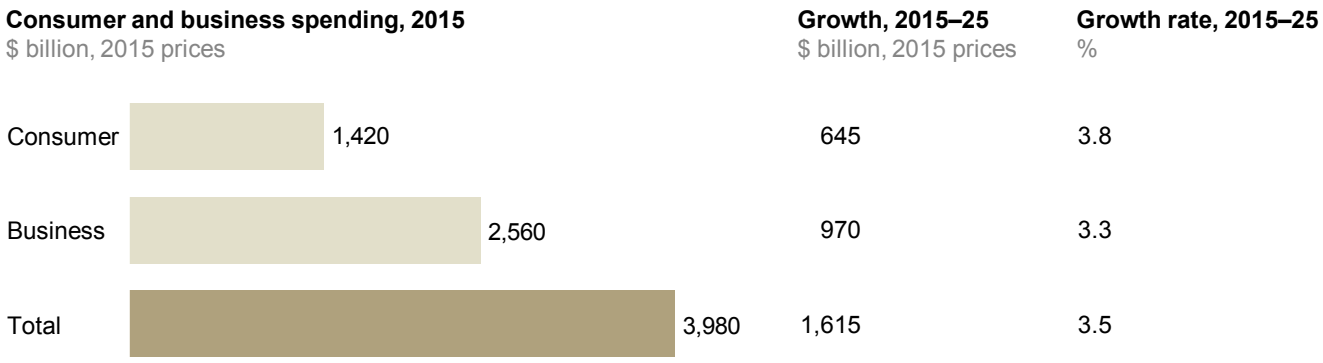
12 When taking into account only the technical costs or equivalent, before royalties and taxes.

THE RISING AFRICAN CONSUMER AND BUSINESS SPENDING OPPORTUNITY IS WORTH $4 TRILLION

There is a $4 trillion opportunity for businesses to tap in the form of rising consumer and business spending. Of this, household consumption accounts for $1.4 trillion, and business spending $2.6 trillion (Exhibit E5).

Exhibit E5

Consumer and business spending in Africa represents a $4 trillion opportunity



SOURCE: Oxford Economics; IHS; McKinsey Global Institute analysis

Nearly
$2.1T
household consumption expected in 2025

Meeting the changing needs of Africa's growing consumer class

Africa's household consumption has continued to grow at a robust pace. Sixty percent of consumption growth has come from an expanding population, and the rest from incomes rising enough to fuel spending on discretionary goods and services as well as basic necessities—all powered by rapid urbanization. Household consumption grew at a 3.9 percent compound annual rate between 2010 and 2015 to reach $1.4 trillion in 2015. To put these trends into an international context, Africa's consumption growth has been the second fastest of any region after emerging Asia, whose consumption growth was 7.8 percent.[13]

We project that household consumption will grow at a robust rate of 3.8 percent in the period to 2025 to reach nearly $2.1 trillion. Half of this additional growth will come from East Africa, Egypt, and Nigeria, but the geographic spread of consumption is changing. South Africa's share of consumption is set to decline from 15 percent in 2005 to 12 percent in 2025 and Nigeria's share from 26 percent to 22 percent over the same period. However, the share of regional consumption is projected to increase in East Africa from 12 percent in 2005 to 15 percent in 2025, and in Francophone Africa from 9 percent to 11 percent (Exhibit E6).

The substantial contribution of rising per capita spending has implications for patterns of consumption. Basic items such as food and beverages are expected to account for the largest share of consumption growth in the period to 2025, but discretionary categories are projected to be the fastest growing: 5.4 percent in the case of financial services, 5.1 percent for recreation-related activities, 4.4 percent for housing, and 4.3 percent for health care.

As per capita spending rises, it becomes even more important for consumer-serving companies to understand where their customers are and the evolution of their incomes, and then to tailor products and services accordingly.[14] We have broken African households into four income brackets: "basic needs" earning less than $5,000 a year; "emerging

[13] The emerging Asia grouping in this report includes seven countries, in line with the IMF definition: China, India, Indonesia, Malaysia, the Philippines, Thailand, and Vietnam.

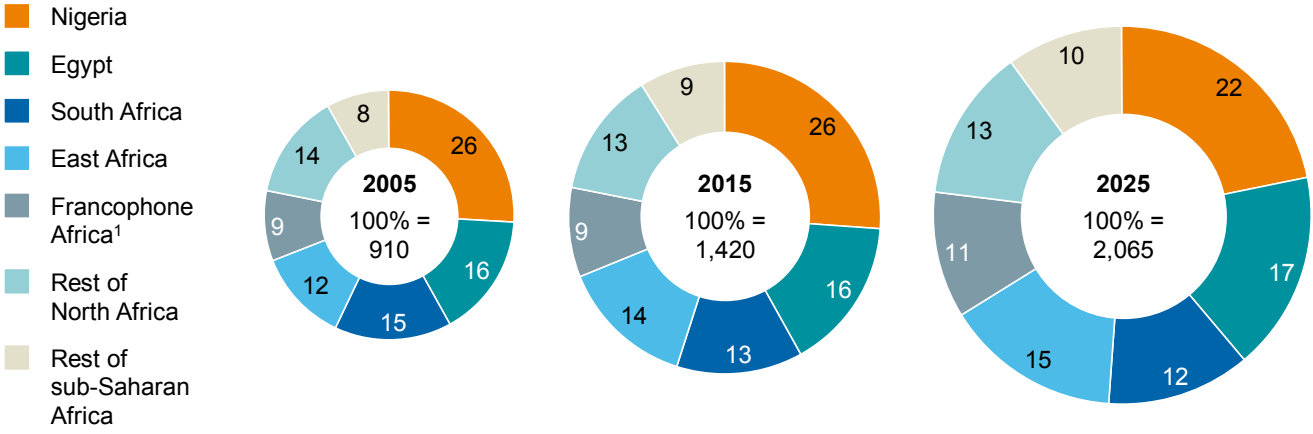
[14] For a global view, see *Urban world: The global consumers to watch*, McKinsey Global Institute, April 2016.

consumers" earning between $5,000 and $20,000; "global consumers" earning between $20,000 and $50,000; and "affluent" households earning more than $50,000.[15] Households earning less than $5,000 spend more than half their income on basic items. Such households account for 24 percent of households in South Africa and around half in Nigeria. That compares with around 20 percent in China. However, higher-income groups—global and affluent consumers—will spend at least 70 percent of their income on discretionary items by 2025, and those segments will account for 20 percent of the overall African population.

Exhibit E6

The regional share of household consumption is projected to grow by $645 billion by 2025

Total household consumption, 2005–25
%; $ billion, 2015 prices



1 Includes 15 countries in Central and West Africa; excludes North Africa and East Africa.
NOTE: Numbers may not sum due to rounding.

SOURCE: Oxford Economics: IHS; African Development Bank; McKinsey Global Institute analysis

Our analysis finds that four broad groups of African consumers will collectively account for $439 billion of the $645 billion in new consumption spending over the next decade (Exhibit E7).

- **Affluent consumers in North Africa and South Africa.** Affluent consumers, who are better off than middle class by OECD standards, will collectively spend an additional $174 billion a year by 2025, or 27 percent of total African consumption growth over this period. Their biggest spending categories will be housing, consumer goods, education, and transportation services.

- **Nigeria.** Africa's largest economy will remain the region's single largest consumer market, accounting for 15 percent of overall growth in consumer spending to 2025. New spending will be relatively evenly split among affluent households, which are expected to spend an additional $30 billion a year by 2025; global consumers, projected to spend $44 billion; and emerging consumers, with $28 billion of spending. The biggest spending categories will be food and beverages, housing, consumer goods, education, and transportation services.

[15] On 2005 international purchasing power parity basis.

- **East Africa.** Ethiopia, Kenya, Sudan, and Tanzania have two segments that will together account for 14 percent of Africa's overall consumption growth to 2025. Emerging consumers in these fast-growing East African markets will spend an additional $54 billion a year by 2025, while global consumers will spend $36 billion. Spending by these two groups is projected to grow rapidly at 5 percent and 7 percent a year, respectively, during this period. Food and beverages will be by far the largest spending category, although there will also be sizable opportunities in housing, consumer goods, and hospitality and recreation.

- **West and Central Africa.** Two consumer segments in five distinct geographic markets—Angola, Cameroon, Côte d'Ivoire, Democratic Republic of Congo, and Ghana—are expected together to account for 11 percent of Africa's consumption growth to 2025. These countries have roughly similar growth prospects and spending categories to those of East Africa. Emerging and global consumers, who are projected to spend more than $70 billion over this period, represent the largest share of new spending.

75
African cities to account for 49% of consumption by 2025

Cities are key to capturing Africa's consumer opportunity.[16] Per capita consumption in large cities is 79 percent higher than the average of these cities' host countries. In Nairobi, Kenya, and in the Nigerian cities of Abuja, Ibadan, Lagos, and Port Harcourt, per capita consumption is more than double the national average. The top three cities in Angola and Ghana account for more than 65 percent of national consumption. Consumption is highly concentrated in a small number of cities—just 75 cities across Africa accounted for 44 percent of total consumption in 2015; this will increase to 49 percent of total consumption by 2025.[17]

Consumer-facing companies will need to make sure they have a meaningful presence in each of Africa's emerging centers of consumption—Egypt, Nigeria, and East Africa—with a primary focus on the largest cities in those and other markets. Doing so will enable them to capitalize on the shifting geographic share of consumption. Given that Nigeria will account for more than 20 percent of African consumption in 2025, consumer-facing companies cannot afford to ignore the market even if the business environment is challenging. In all consumer markets, companies need to tailor their product and service offerings, and their pricing, to Africa's distinct consumer segments. Finally, informal retail channels are an important route to market in many countries, and companies will need to design their sales and distribution models to cater to these.

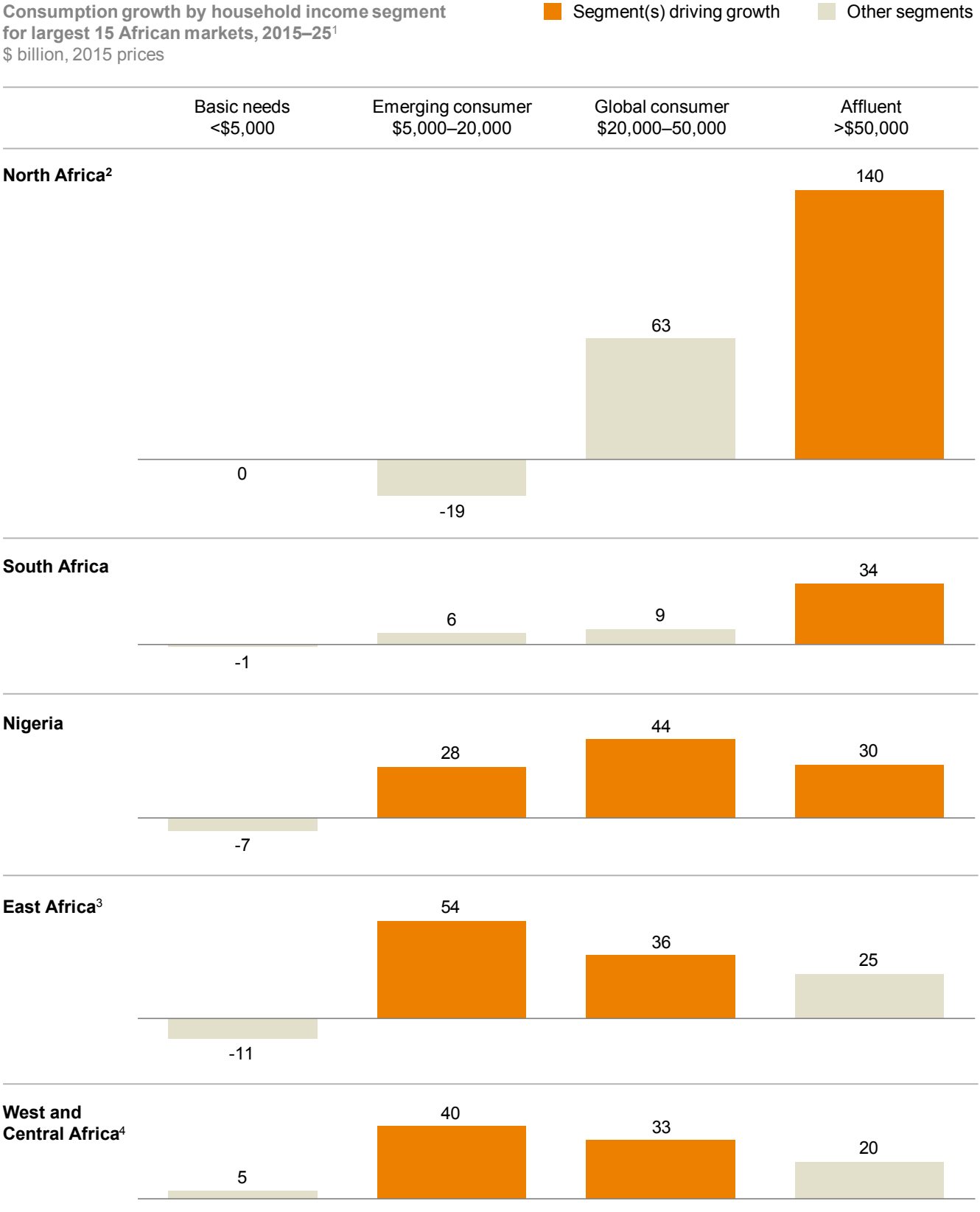
Cities are key to capturing Africa's consumer opportunity.

[16] Rural areas could be a second priority once the potential of urban areas is fully met, given the concentration of consumption in urban areas (approximately two-thirds) and the relatively higher cost to serve rural customers.
[17] McKinsey Global Institute Cityscope, 2015.

Exhibit E7

Different segments power growth in each consumer spending pool

Consumption growth by household income segment for largest 15 African markets, 2015–25[1]
$ billion, 2015 prices



1 These 15 largest African markets generated 89% of 2015 demand and will be responsible for 82% of consumption growth between 2015 and 2025.
2 North Africa includes Algeria, Egypt, Morocco, and Tunisia. Egypt will account for 62% of the region's growth in consumption.
3 East Africa includes Ethiopia, Kenya, Sudan, and Tanzania.
4 We focus on five major markets in West and Central Africa: Angola, Cameroon, Côte d'Ivoire, Democratic Republic of Congo, and Ghana.

SOURCE: Canback Global Income Distribution Database (C-GIDD); African Development Bank; Oxford Economics; IHS; McKinsey Global Institute analysis

Supplying materials, services, and capital goods to Africa's businesses

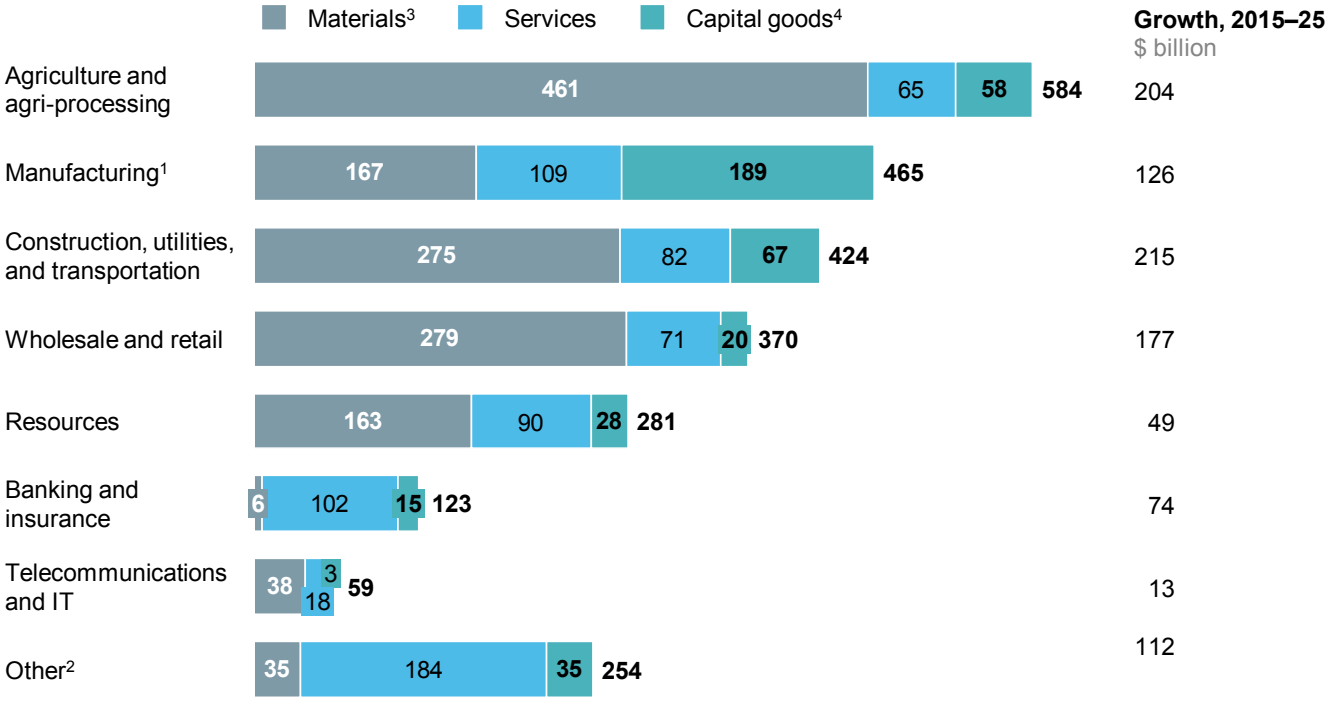
While the African consumer story has generated most headlines, the relatively unsung but rapidly growing business-to-business (B2B) market is an even larger spender. Companies in Africa spent some $2.6 trillion in 2015, 40 percent of it in Nigeria and South Africa. Africa's B2B spending is expected to increase to $3.5 trillion by 2025, with half of that total being spent on materials, 16 percent on capital goods, and the remainder on a wide range of services including business and financial services, transportation, and telecommunications. Services consumption is set to grow the quickest at 3.5 percent per year.

Companies selling to other businesses—like companies serving consumers—need a detailed understanding of trends at the sector level to be successful. Today, the largest-spending B2B sector is agriculture and agri-processing, and the spending largely goes toward input materials. This sector is expected to increase spending by an additional $204 billion over the next decade, reflecting both a growing population and rising incomes that are boosting demand for agricultural output and more sophisticated food products (Exhibit E8). The fastest-growing sectors are set to be financial services, construction, utilities and transportation, and wholesale and retail trade. B2B spending in the telecommunications, resources, and manufacturing sectors is likely to grow more slowly than in other sectors.[18]

Exhibit E8

Africa's business sectors have distinct spending profiles

Company spending by sector and category (excluding salaries), 2015
$ billion



1 Heavy, light, and R&D-intensive manufacturing.
2 Health care, other services, and smaller sectors.
3 Material costs directly attributed to the cost of production (as part of the finished product) and material costs that do not form a part of the finished product.
4 Defined as the average capital expenditure by a company in this sector (smoothing out the effect of large capital expenditure projects).
NOTE: Numbers may not sum due to rounding.

SOURCE: MGI African companies database; CIQ database; IHS; WCIS; BMI; Ovum; Yankee; McKinsey Purchasing and Supply Management Practice; McKinsey BMI Practice; McKinsey Oil and Gas Practice; McKinsey Global Banking Pools; McKinsey Global Institute analysis

[18] The slower growth of telecommunications services is based on declining long-term average revenue per user, even as mobile penetration rates continue to grow. The estimate is based on revenue for voice and data, not enterprise services or innovative products, which may yet emerge as a significant source of telecommunications growth.

60%
of B2B spending from companies with <$500 million annual revenue

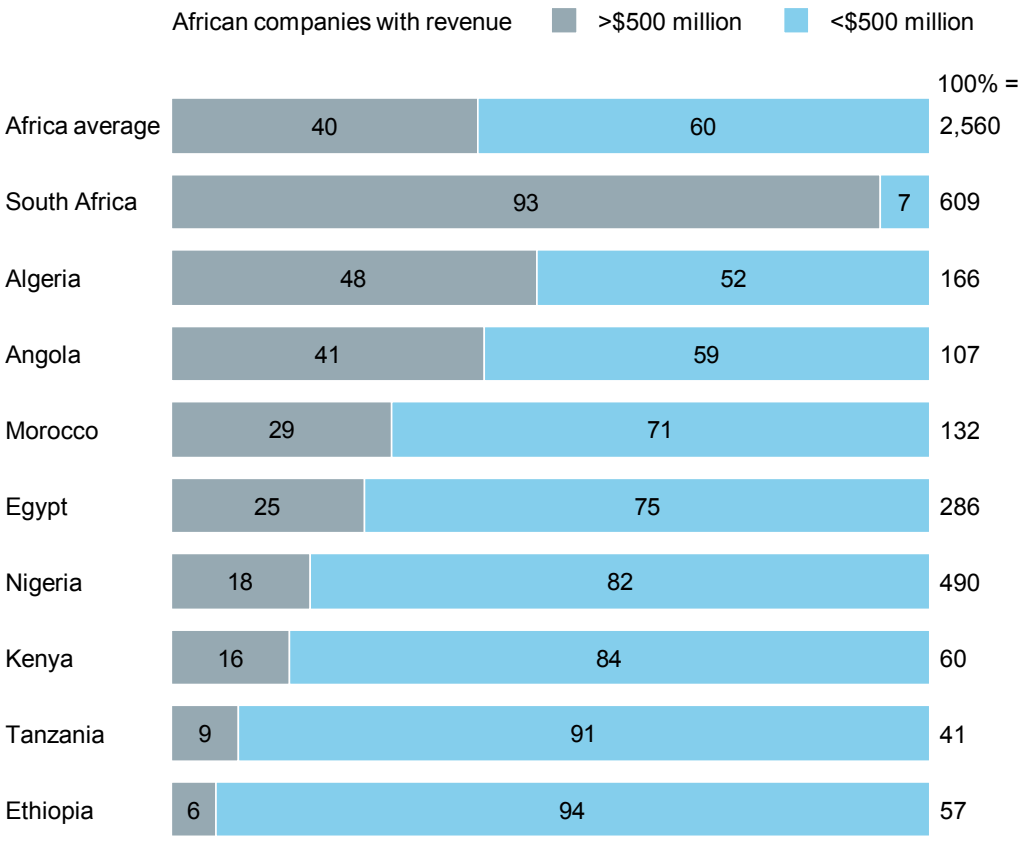
Even a view of sectors may not be sufficient to succeed; market intelligence needs to be detailed down to the level of individual companies. Across Africa, only 700 companies with annual revenue exceeding $500 million account for more than 40 percent of total B2B spending. In other words, 60 percent of B2B spending is by companies smaller than this revenue threshold (Exhibit E9). In Algeria, these large companies generate 48 percent of total B2B spending; in South Africa, large companies command more than 90 percent of the market. In such markets, it makes sense to target large firms. However, small companies dominate in other African economies. In Ethiopia, large companies account for less than 10 percent of B2B spending; in Nigeria and Kenya, it's less than 20 percent. The size of companies varies by sector, too. Large companies dominate in financial services, resources, and telecommunications, while agriculture, construction, utilities, and transportation sectors tend to have a higher share of smaller companies.

Given the predominance of smaller businesses in Africa, companies will need a clear plan for how to serve them, including tailored offerings, targeted sales forces, and distribution and supply chains appropriate to their needs. These smaller companies are well worth developing as customers. Many of these companies are growing rapidly and will make significant contributions to Africa's growth.

Exhibit E9

Smaller companies will account for most business spending in countries other than South Africa

Share of company spending by company scale, 2015
%; $ billion



NOTE: Numbers may not sum due to rounding.

SOURCE: MGI African companies database; CIQ database; IHS; WCIS; BMI; Ovum; Yankee; McKinsey Purchasing and Supply Management Practice; McKinsey BMI Practice; McKinsey Oil and Gas Practice; McKinsey Global Banking Pools; McKinsey Global Institute analysis

Nearly

2x

manufacturing output possible by 2025

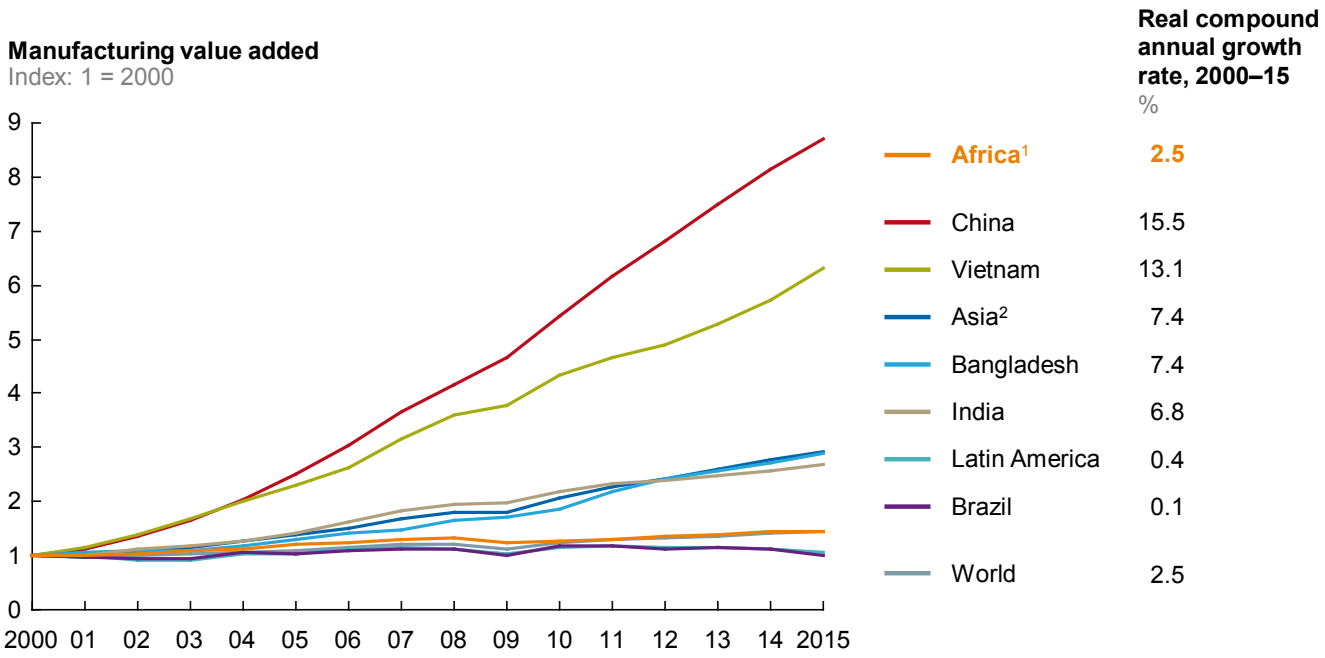
AFRICA HAS THE POTENTIAL TO ACHIEVE NEARLY $1 TRILLION IN MANUFACTURING OUTPUT IN 2025

Manufacturing is a vital engine of economic development, but Africa's economies overall have underperformed. As Africa's economies have grown and diversified over the past two decades, there has been a steady increase in manufacturing output—indeed, a rapid increase in Ethiopia and Tanzania, in particular. Nevertheless, Africa's growth in manufacturing value added of 2.5 percent a year between 2000 and 2015, while roughly in line with the global average, lagged far behind Asia's 7.4 percent (Exhibit E10). In 2015, Africa's total manufacturing output was worth around $500 billion and the vast majority of that was focused in five countries—Egypt, Morocco, Nigeria, South Africa, and Tunisia. Seventy percent of this production was focused on meeting domestic needs and was consumed in the country of manufacture; some 10 percent was traded within Africa, and just 20 percent was exported beyond Africa. Africa produced just 1.4 percent of global manufacturing exports in 2014, and its share has remained within the narrow band of 1.0 to 1.5 percent since 2000. By contrast, China grew its share of global exports from 4.5 percent in 2000 to 15 percent in 2014.

MGI estimates that, by 2025, Africa could nearly double its current manufacturing output of $500 billion to $930 billion. On current trends, output is set to rise to an estimated $643 billion by 2025. However, $287 billion could be added to that if African countries take decisive action to create an improved environment for manufacturers. The rewards of accelerated industrialization would be immense. There would be a positive step change in national wealth, tax receipts, productivity and skills, and balance of payments. An expanded and more productive manufacturing sector could also create six million to 14 million stable jobs over the next decade, an increase of 5 to 11 percent from 2015.

Exhibit E10

Since 2000, Africa's manufacturing value-added growth has equaled the global average but has lagged behind that of emerging Asian champions



1 Cameroon, Egypt, Kenya, Morocco, Nigeria, Senegal, South Africa, Tunisia, and Zimbabwe.
2 Bangladesh, China, Hong Kong, India, Indonesia, Japan, Malaysia, Pakistan, Philippines, Singapore, South Korea, Sri Lanka, Taiwan, and Thailand.

SOURCE: IHS; McKinsey Global Institute analysis

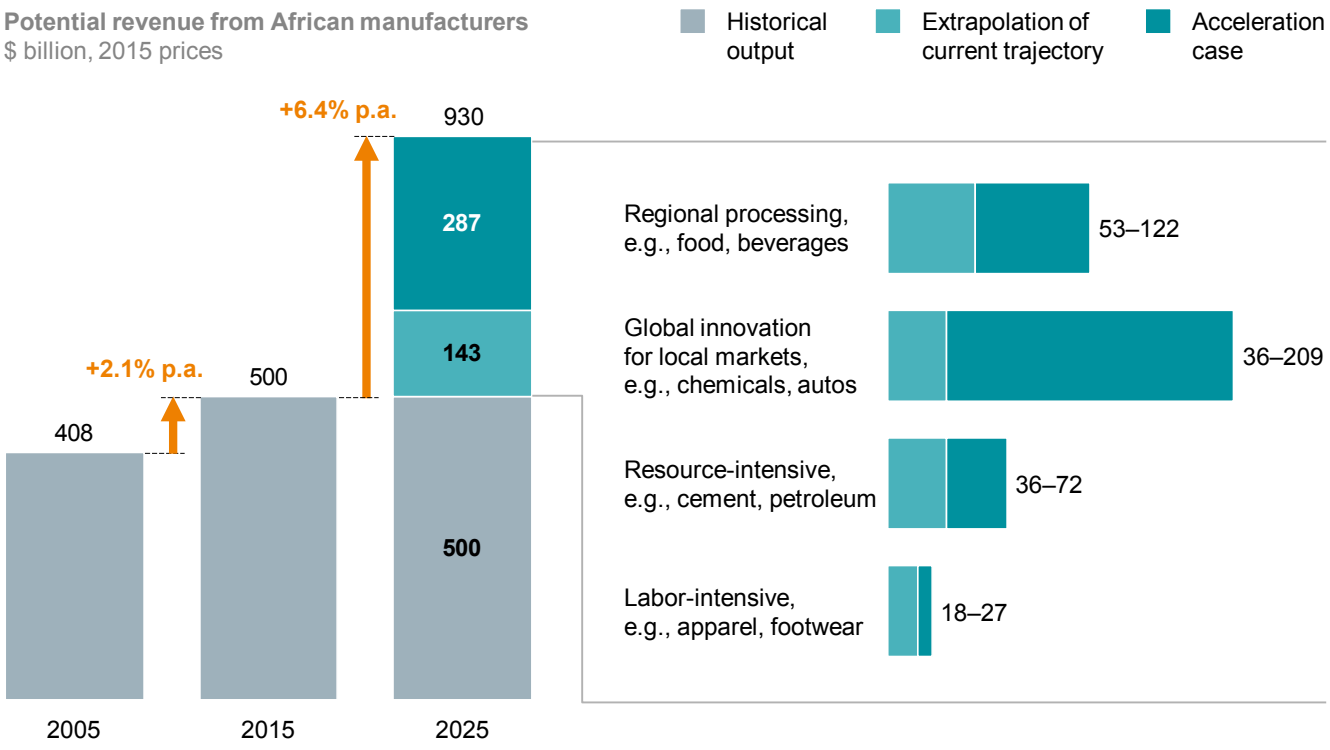
Four categories of products can contribute to a doubling of Africa's manufacturing output

Our analysis finds four categories of products that could increase output in the period to 2025 by $430 billion so that overall output approaches the $1 trillion mark (Exhibit E11).

The largest opportunity is in a category of goods we classify as global innovation for local markets, which includes vehicles and chemicals.[19] This opportunity will likely be feasible for only some African countries, primarily Egypt, Morocco, South Africa, and Tunisia. In these economies, manufacturers have already significantly increased their capacity in these areas. Morocco and Egypt expanded their automotive sectors by around 10 percent a year in real terms between 2004 and 2014. While South Africa's larger automotive sector grew more slowly, it still added nearly $5 billion in incremental revenue over that period, while its chemicals sector added more than $6 billion in incremental revenue. African manufacturers have an opportunity to supply more local demand and increase their exports in this category. By raising their share in the ten largest existing export markets to that of the highest quartile, Africa's four largest manufacturing nations could earn up to $209 billion in additional annual revenue in 2025—six times what they would achieve if historical growth rates remained in place.

Exhibit E11

Africa has an opportunity to triple historical manufacturing output growth rates, and to double output, in ten years



NOTE. Numbers may not sum due to rounding.

SOURCE: IHS; UNCTAD; McKinsey Global Institute analysis

[19] All goods in this category have similar traits. Competition is based on innovation and quality. There is high R&D intensity of between 5 and 25 percent. While some components are traded globally (with a trade intensity of 40 to 50 percent), there is a tendency toward greater regional assembly and production.

Reflecting the continent's growing population and rising household incomes, manufacturing of regional processing goods such as food and beverages is a second major opportunity. We estimate that local manufacturers could increase their revenue in such segments by $122 billion by 2025, almost triple the expected growth at the current trajectory. There is also an opportunity to earn up to $72 billion from resource-intensive products such as cement, and up to $27 billion more from labor-intensive goods such as apparel and footwear.

Three-quarters of the potential could come from meeting domestic demand, and the rest from enhancing exports

Three-quarters of the growth in potential output would come from meeting intra-African demand and substituting imports of manufactured goods, which today are at levels much higher than in peer regions. With consumer and B2B markets growing strongly, and rising sophistication among consumers and businesses, we can expect rising demand for a wide range of manufactured goods, including processed food and beverages, apparel, appliances, cars and trucks, fuel, construction materials, and industrial inputs. The other one-quarter could come from accelerating growth in niche manufacturing exports.

1/3
of food, beverages, and similar processed goods consumed in Africa is imported

There is a huge opportunity for import substitution (Exhibit E12). If Africa's firms and governments work together to unleash an industrial revolution across the continent, we estimate that the region can more than double its supply to intra-African markets by 2025, increasing annual revenue by $326 billion, three-quarters of the $430 billion potential increase in output.

Today, Africa imports one-third of the food, beverages, and similar processed goods it consumes. By contrast, member states of the Association of Southeast Asian Nations (ASEAN) import approximately 20 percent of such goods from outside their region, and the South American countries in the Mercosur trade bloc import about 10 percent.[20] About 60 percent of Africa's supply of global innovation goods, such as cars and chemicals, are imported—twice the level for Mercosur. Even in cement—a resource-intensive sector with abundant local raw materials—Africa imports 15 percent of its needs, compared with about 5 percent in ASEAN and Mercosur states.[21] In all these categories, African manufacturers can and should target significantly higher levels of local supply.

African manufacturers can and should target significantly higher levels of local supply.

About $100 billion could be added to Africa's manufacturing output if, as we have discussed, manufacturers move decisively to produce more in the global innovation category, as well as more labor-intensive tradable goods, and export these products. North African countries are already capitalizing on their proximity to Europe's vast consumer markets to expand their exports of apparel and other labor-intensive goods. Another helpful development has been the African Growth and Opportunity Act (AGOA), a US trade act that was introduced in 2000 and recently extended to 2025. It provides some 40 sub-Saharan nations with tariff-free access to the US market and a major cost advantage in thousands of product lines. For instance, AGOA makes various items of women's apparel from Ethiopia and Kenya sold to the United States 25 to 50 percent cheaper than prices for the same goods in European markets. Thus far, African companies have not fully capitalized on the

[20] ASEAN members are Brunei, Cambodia, Indonesia, Laos, Malaysia, Myanmar, Philippines, Singapore, Thailand, and Vietnam. Mercosur comprises the economies of Argentina, Brazil, Paraguay, Uruguay, and Venezuela.

[21] On a tonnes basis.

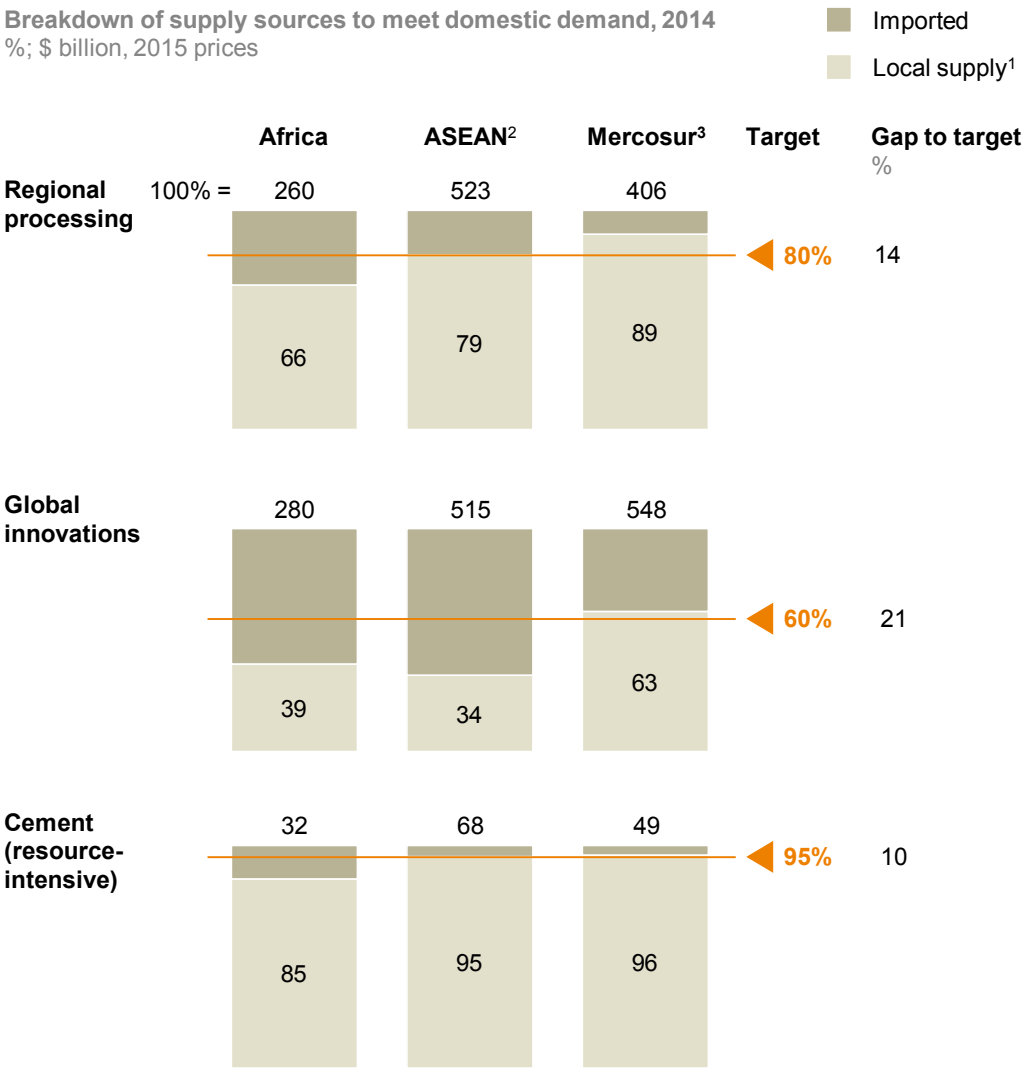
US opportunity. Indeed, despite AGOA, labor-intensive exports to the United States have declined by 6 percent a year over the past decade.

Achieving an African manufacturing revolution is essential, but it will not be easy. Our analysis suggests that Africa cannot achieve a meaningful increase in its share of global manufacturing purely on the basis of low labor costs. African economies need to boost competitiveness in manufacturing on seven dimensions: labor productivity, electric power, industrial land, movement of goods, business environment, financial systems, and tariffs. Depending on which categories of manufacturing offer the best opportunities for competitive growth in their countries, governments can prioritize specific interventions.

Exhibit E12

Africa imports a large share of products that could be manufactured within the region

Breakdown of supply sources to meet domestic demand, 2014
%; $ billion, 2015 prices



1 Includes domestic output and intraregional trade.
2 The Association of Southeast Asian Nations comprises Brunei, Cambodia, Indonesia, Laos, Malaysia, Myanmar, Philippines, Singapore, Thailand, and Vietnam.
3 The Mercosur trade bloc comprises Argentina, Brazil, Paraguay, Uruguay, and Venezuela.
NOTE: Numbers may not sum due to rounding.

SOURCE: UNCTAD; WITS-UN Comtrade; *International Cement Review*; IHS; IMF; McKinsey Global Institute analysis

LARGE COMPANIES PLAY A CRITICAL ROLE IN GROWTH, AND AFRICA NEEDS MORE OF THEM

There is no shortage of exciting business opportunities across Africa, and the region is home to many fast-growing companies in a variety of sectors from resources to manufacturing. Nevertheless, it remains heavily underrepresented in the number of large companies that are the primary drivers of growth, investment, corporate tax revenue, and productivity in all economies. Africa needs more large companies to make a greater contribution to the economy. The success of many African companies demonstrates that bold growth strategies are already possible, and that other businesses in the region need not wait for governments to create an ideal environment in which to operate.

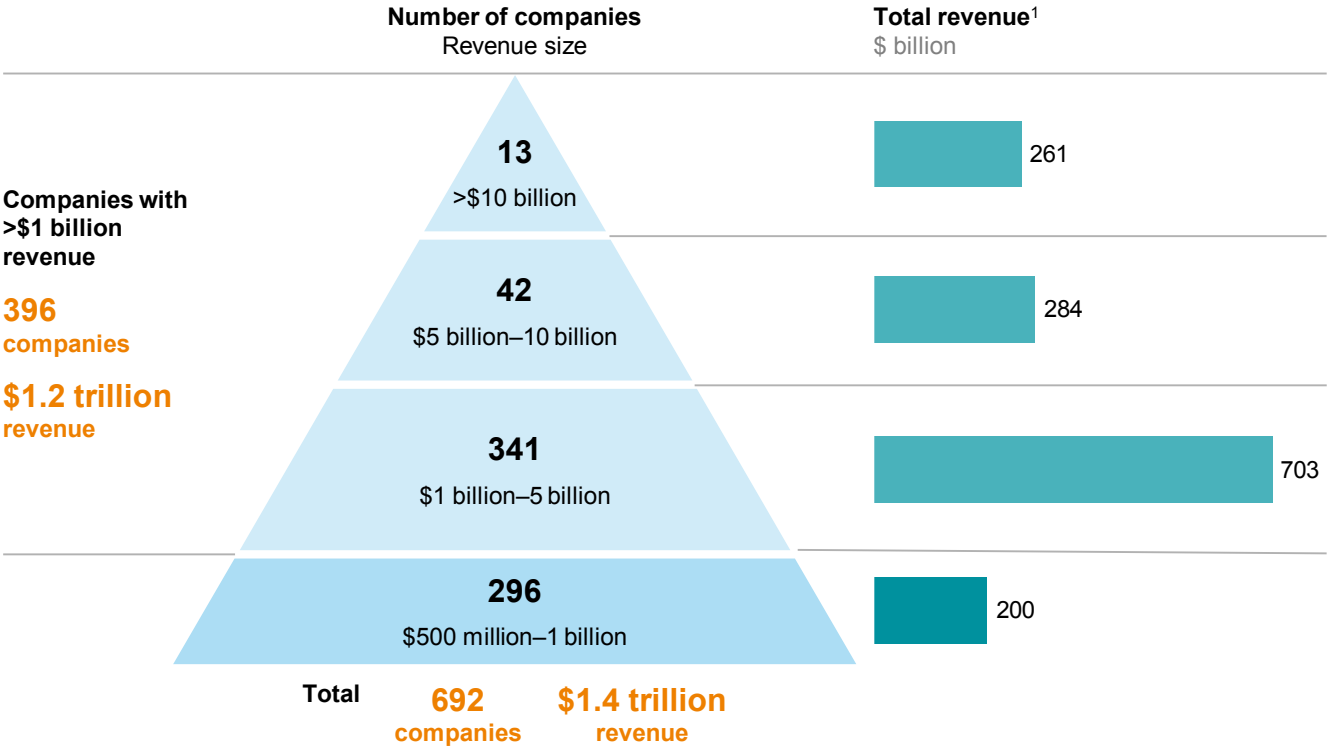
400
companies earn $1 billion or more annually in Africa

MGI's database of large African companies—the first of its kind—includes 700 companies with annual revenue of more than $500 million each (including 400 companies that earn more than $1 billion); collectively, the revenue of the 700 totals $1.4 trillion (Exhibit E13). The database shows that Africa arguably has a more diversified corporate landscape than might have been expected. For instance, we find that around two-fifths of the 700 companies are publicly listed, and that family-owned businesses account for only 10 to 20 percent of large companies. Twenty-seven percent of the 700 are multinational corporations, while the rest are large domestic companies; of this latter group, 17 percent of the 700 are state-owned enterprises (Exhibit E14). Many are increasingly pan-African in their operations and are active in increasingly diverse sectors. Seventy percent of revenue today comes from non-resources sectors. Successful African companies are emerging in sectors such as retail, financial services, and transportation services. Half of the continent's large companies are based in South Africa.

Exhibit E13

Around 700 companies in Africa account for $1.4 trillion in revenue

Breakdown of companies by revenue size, April 2016

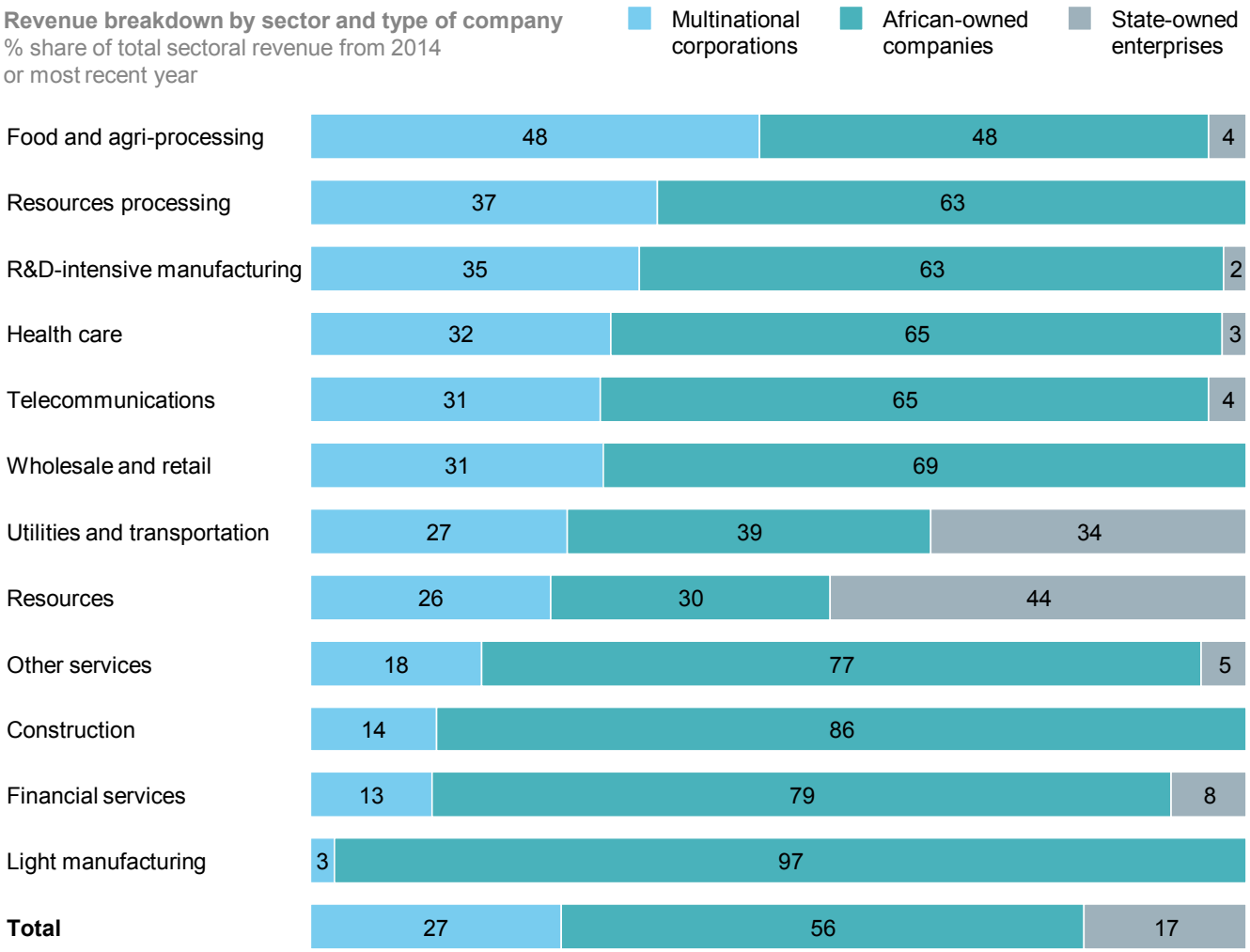


1 2014 or most recent data.

SOURCE: MGI African companies database; McKinsey Global Institute analysis

Exhibit E14

Corporate Africa comprises mostly local companies, followed by multinational corporations and state-owned enterprises


Revenue breakdown by sector and type of company
% share of total sectoral revenue from 2014 or most recent year
Multinational corporations
African-owned companies
State-owned enterprises
Food and agri-processing 48 48 4
Resources processing 37 63
R&D-intensive manufacturing 35 63 2
Health care 32 65 3
Telecommunications 31 65 4
Wholesale and retail 31 69
Utilities and transportation 27 39 34
Resources 26 30 44
Other services 18 77 5
Construction 14 86
Financial services 13 79 8
Light manufacturing 3 97
Total 27 56 17

NOTE: Numbers may not sum due to rounding.

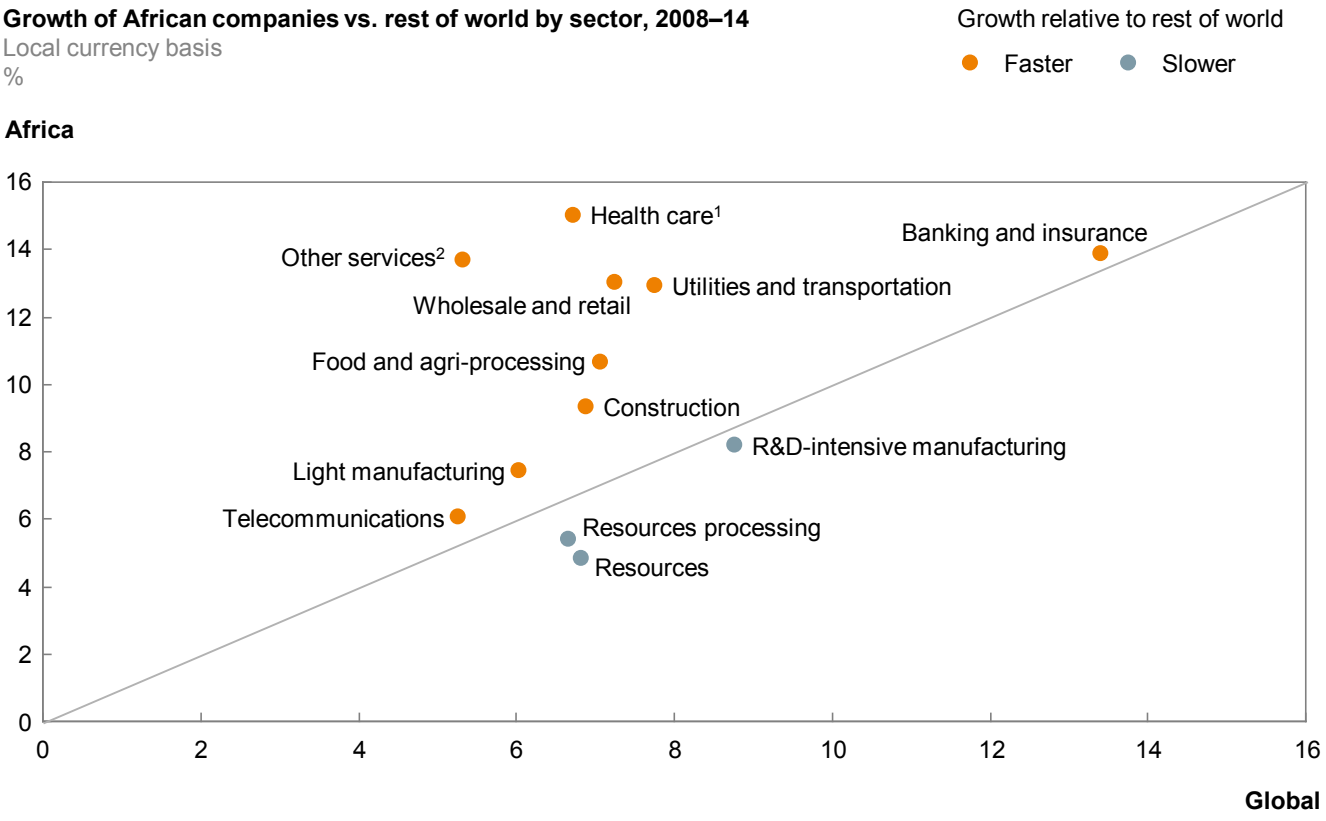
SOURCE: MGI African companies database; McKinsey Global Institute analysis

Our analysis finds that many African companies are successful. They grow faster than their peers in the rest of the world, and they are more profitable than these peers in most sectors (Exhibit E15). It is also worth emphasizing that six sectors are particularly promising for companies. In these sectors—wholesale and retail, food and agri-processing, health care, financial services, light manufacturing, and construction—large African companies were both more profitable and faster growing than global peers. In addition, there appears to be significant potential for further growth given the fact that these six sectors today remain relatively fragmented: consolidation could unleash even more opportunity for corporate Africa.

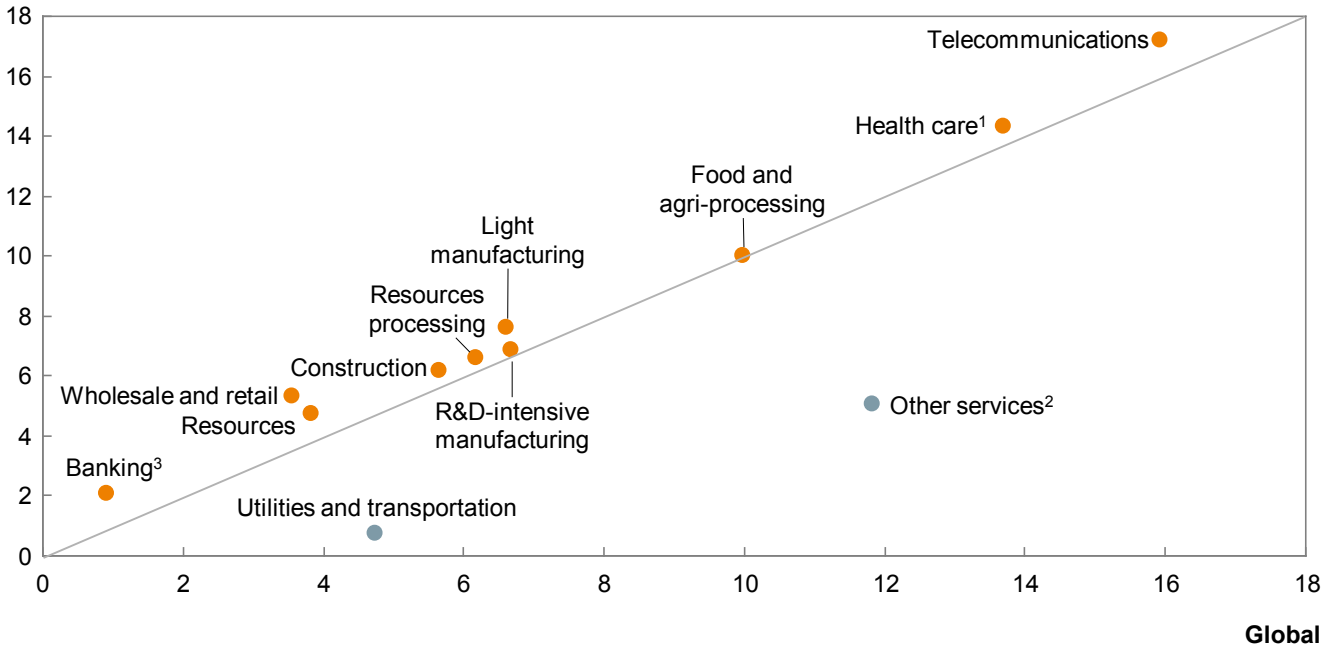
Exhibit E15

Large companies in Africa have tended to grow faster and have been more profitable than their global peers

Growth of African companies vs. rest of world by sector, 2008–14
Local currency basis
%



Profitability of African companies vs. rest of world by sector, 2013–14
Net operating profit less adjusted taxes (NOPLAT) as % of revenue



1 n = 4 for health care due to sector size and data availability.
2 Other services includes information technology, media, real estate, marketing, and other business services.
3 Banking profitability measured by return on assets in percentage terms.

SOURCE: McKinsey Corporate Performance Analytics; McKinsey Global Banking Pools; McKinsey Global Institute analysis

However, as a whole, Africa lags behind other emerging regions in its prevalence of large companies. It has about 60 percent the number one would expect if it were on a par with peer regions. The only exception to this situation is in South Africa, which has 9.6 companies per $10 billion in revenue, compared with 1.9 in North Africa and 1.1 in Nigeria. South Africa accounts for nearly half of all Africa's large companies, and North Africa accounts for one-fifth. There are too few large companies in the rest of the region.

Moreover, Africa's large companies are not as large as they need to be to make the most of promising sources of growth. The average large African corporation has annual revenue of $2.7 billion, compared with $4 billion to $4.5 billion in comparable emerging markets such as Brazil, India, Mexico, and Russia. Outside South Africa, Africa's firms earn less than half the revenue of their emerging market peers as a proportion of GDP. No African company is featured in the global Fortune 500, which ranks firms by revenue; Brazil and India, whose GDPs are similar to Africa's, each boast seven companies on that list, while China has 98. Taking numbers and size into account, the total revenue pool of large companies in Africa is one-third of what it could potentially be (Exhibit E16).[22]

The low level of consolidation in several high-growth sectors is an opportunity for large companies, but the flip side of this—a high degree of informality in many African economies—is a challenge. Formal firms in Africa must compete against informal or unregistered businesses that typically do not pay tax or comply with labor and other regulations; almost 40 percent of businesses rank competition against informal firms as a major constraint.[23] In contrast, the industry structure in some industries including telecommunications is highly consolidated, which makes it difficult for smaller players to grow. Overall, these patterns mean that companies need to be quite targeted in their expansion strategies.

Total revenue of large African companies is only **1/3** of its potential

Looking at the top 100 African companies, we find that their success has rested on three broad foundations: the vast majority have built growth by building a strong position in their home market before expanding into regional or pan-African markets; close to four-fifths of them have focused on a single sector rather than diversifying; and the large majority of them have driven growth through best-in-class execution and operations. The prevalence of innovation-driven strategies is much lower among Africa's largest companies than it is among their peers in other emerging regions, particularly Asia, where half of companies at some point prioritize technological innovation, innovative business models, or product excellence. Only 23 of the top 100 African companies have expanded through this approach, and only 7 percent of those that focused on excellent execution have later innovated. This is a concern. To take full advantage of Africa's potential, large firms will need to innovate more.

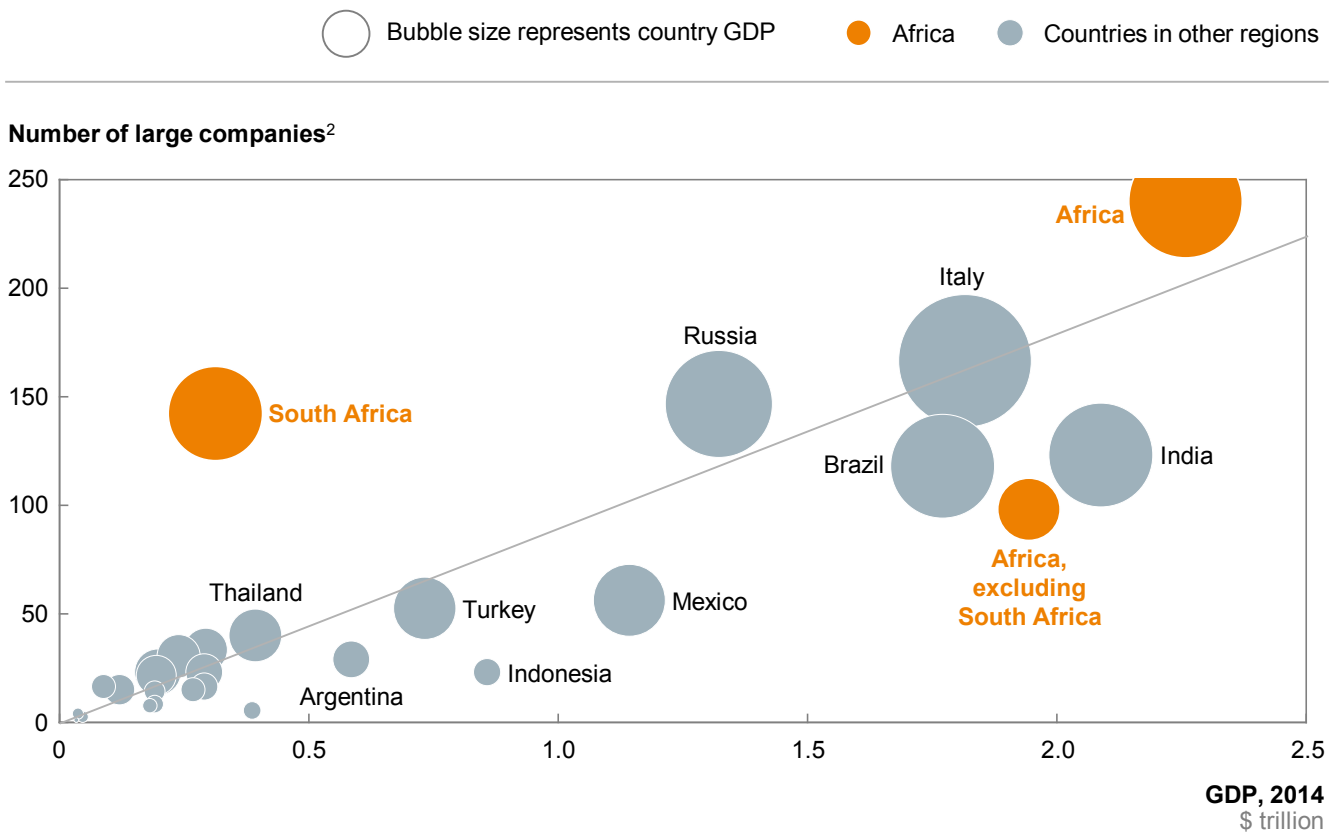
Companies looking to grow across the continent should build a strong position in their home market, use that as a base for expanding into markets well beyond their immediate region, adopt a long-term perspective and build the partnerships needed to sustain success over decades, be ready to integrate what would usually be outsourced, and invest in building and retaining talent. They should look for opportunities in six sectors MGI identifies with "white space"—wholesale and retail, food and agri-processing, health care, financial services, light manufacturing, and construction. These sectors are characterized by high growth, high profitability, and low consolidation.

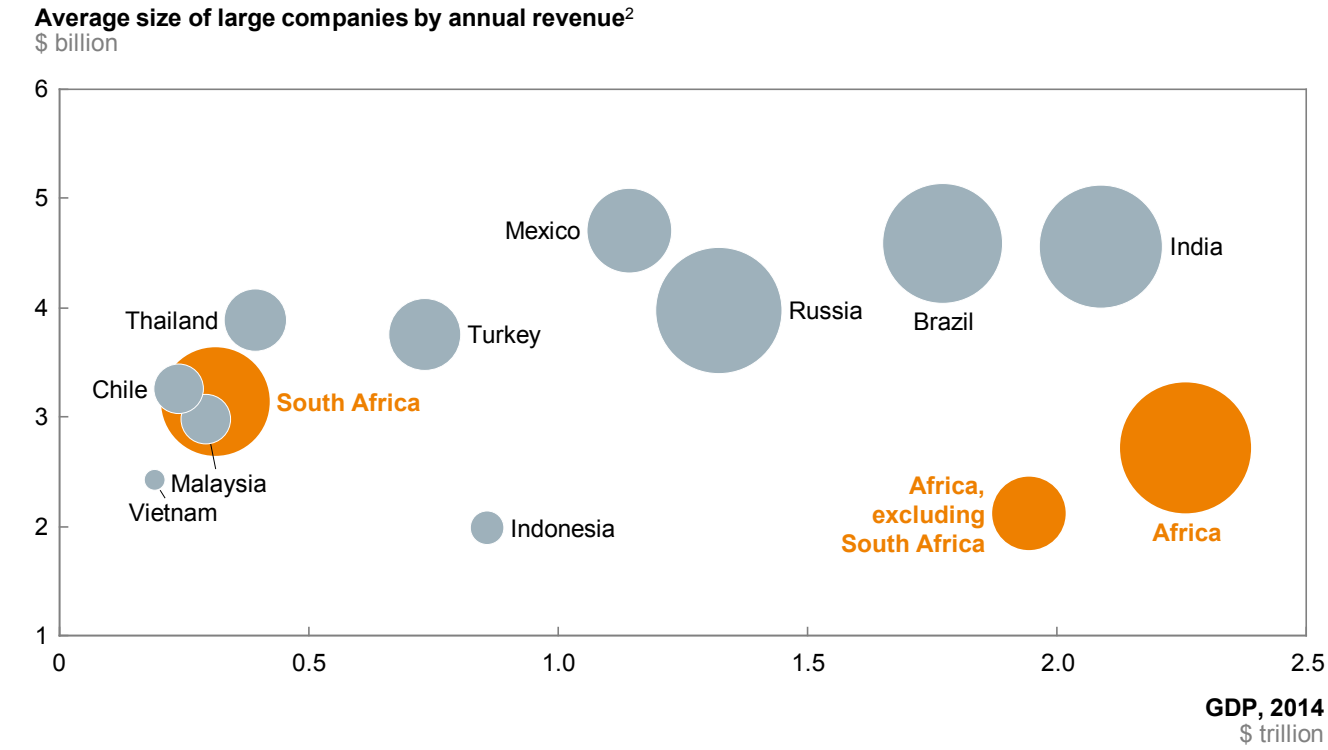
[22] These estimates exclude South African companies.

[23] This is the worst ranking of all regions globally. *Enterprise surveys*, World Bank, 2016.

Exhibit E16

Corporate Africa's revenue pool[1] is a third of what it could be because there are fewer large companies and they are smaller than those in other emerging markets





1 Excluding South Africa.
2 In this analysis, large companies are defined as those with more than $1 billion in revenue per year. These analyses exclude multinational corporations and state-owned enterprises.

SOURCE: McKinsey Companyscope; MGI African companies database; McKinsey Global Institute analysis

GOVERNMENTS SHOULD CONSIDER SIX IMPERATIVES TO ACCELERATE, UNDERPINNED BY TRANSFORMED LEADERSHIP AND GOVERNANCE

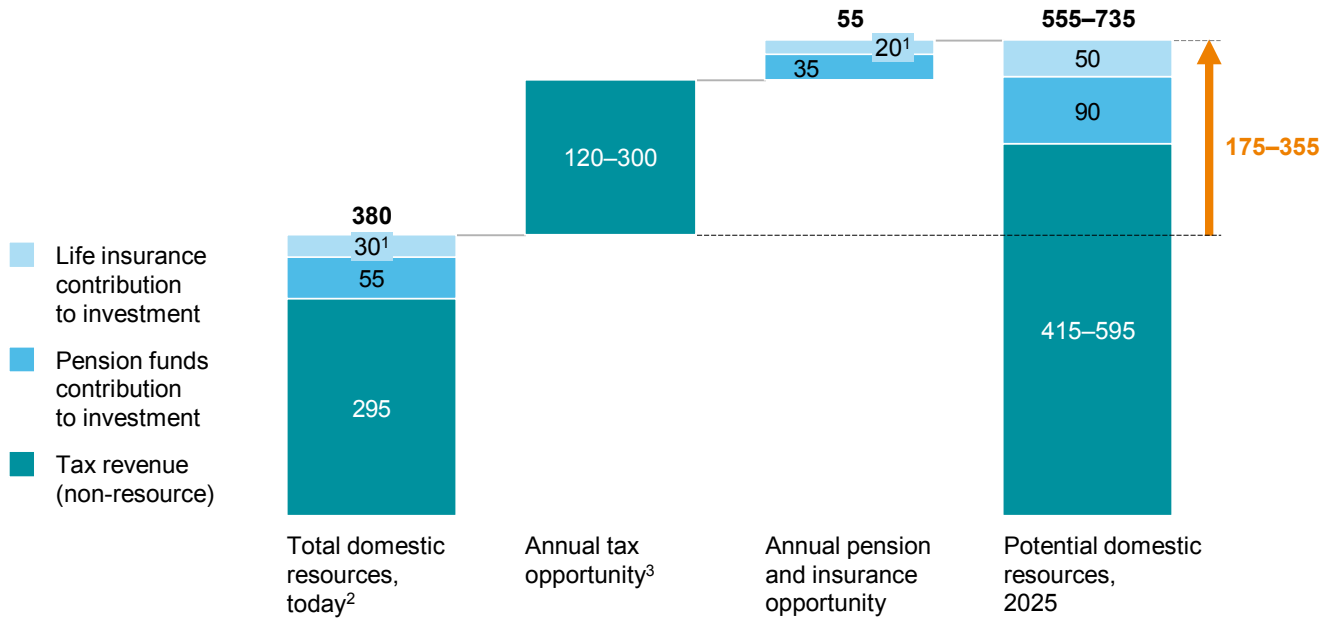
African governments face many challenges, including pressure on public finances, a slowdown in foreign investment, and the need to provide housing, infrastructure, and services in fast-growing cities. At the same time, challenging global economic conditions put pressure on African companies and reinforce the imperative to develop an environment that enables the dynamism of the private sector and boosts investment and productivity. The continent's growing population offers a potential demographic growth dividend, precious in a broadly aging world, but African economies need to be able to create opportunities for an expanding workforce and ensure that their energy is mobilized to fuel economic activity. To help African economies meet these challenges and make the most of strong long-term fundamentals, governments can prioritize action in six areas and address one overarching imperative—to improve governance. The six priorities are the following.

1. **Mobilize domestic resources.** Africa needs to take bold steps to mobilize more of its own funding to finance its development—an urgent imperative given weakening currencies, rising debt-to-interest-rate spreads, and higher volatility in capital inflows. We find that two levers are available to governments to mobilize an additional $175 billion to $355 billion in domestic resources: enhanced tax collection, and increased stimulation of domestic investment via state and large corporate pension funds and increased penetration of insurance products (Exhibit E17).

Exhibit E17

Africa can mobilize $175 billion to $355 billion of domestic resources, including tax revenue, and increased pension and insurance penetration

Potential increase in African domestic resources by 2025
$ billion



1 Excludes the contribution of group life premiums, estimated to be 40% of total life insurance premiums; figure based on South African data. This type of premium is excluded because it is short term and therefore not amenable to long-term investment.
2 Tax estimates from 2013; insurance and pension fund estimates from 2014.
3 No official estimates for potential tax revenue are publicly available. The assumption (based on available literature, and discussions with tax authorities and experts) of the share of tax not collected due to failure to file, underreporting, or late payment is likely to be as much as 30 to 50 percent of total potential tax revenues in Africa. Resource rents are excluded.
NOTE: Numbers may not sum due to rounding.

SOURCE: National tax experts; African Economic Outlook; Swiss Re Sigma; Africa Re; World Development Indicators, World Bank; OECD; McKinsey Global Insurance Pools; McKinsey Public Sector Practice; McKinsey Global Institute analysis

Annual infrastructure investment needs to double to

$150B

in period to 2025

2. **Aggressively diversify economies.** Although Africa's economies have diversified to an extent, more is needed to overcome economic vulnerabilities. Compounding this, while the business environment in Africa has improved a great deal over the past 20 years, there is still a long way to go. In the World Bank's 2016 *Doing business* report, only seven African states—Botswana, Mauritius, Morocco, Rwanda, Seychelles, South Africa, and Tunisia—placed in the top half of the ranking. Governments can set out strategies to encourage growth in high-potential sectors in close cooperation with business, based on a clear understanding of their countries' comparative advantages—as Morocco has done in the cases of manufacturing, agri-processing, and business process outsourcing. Industrial policy, in particular, could focus on productivity, market access (regional and international), and integration into global supply chains. Any successful diversification strategy needs to be guided by a long-term national vision with transparent objectives, which sends a clear signal to investors in focus sectors, and guides resource allocation and trade-offs. To support diversification, governments can also take steps to improve the enabling environment for business, including by strengthening transportation and electric power infrastructure, increasing openness to foreign investment, and reviewing new-business registration, bankruptcy laws, and other regulations key to a healthy business environment. Governments should also consider how to increase the attractiveness of sectors with comparative advantage for investors through proactive marketing, a dedicated investment agency, and support for investors even after a deal is signed.

3. **Accelerate infrastructure development.** Poor infrastructure, including electricity provision, and poor transportation links contribute to the lack of scale among Africa's companies and hinder regional integration. Africa's spending on infrastructure has doubled from an average of $36 billion in 2001–06 to $80 billion in 2015 in nominal terms but, as a share of GDP, infrastructure investment has remained at around 3.5 percent, less than the 4.5 percent that MGI research has found is necessary each and every year until 2025. In absolute terms, this means doubling annual investment in African infrastructure to $150 billion. Government needs to develop bankable projects, ensure adequate financing, put in place effective public-private partnerships, and optimize spending. Other agencies—both public and private—also have a role to play in delivering infrastructure and attracting or providing funding.

4. **Deepen regional integration.** One of the major thrusts of government effort has to be continuing to help deepen regional integration. Investors are attracted to large markets, and integration is needed to help African companies build scale. Driving closer regional integration is also important for unleashing faster industrialization given that, as we have noted, three-quarters of the growth potential in Africa's manufacturing output lies in meeting demand within the continent. Unlike the large integrated markets of China, Brazil, and the United States, Africa is a patchwork of more than 50 mostly small economies with only a limited degree of economic integration and political collaboration. That helps explain why so many large African companies have focused their expansion on their immediate regions. Africa's economic fragmentation has domino effects on companies' ability to source or sell inputs along supply chains in multiple sectors. There are few manufacturing and services hubs as production is highly dispersed across the continent, hindering the formation of new businesses, limiting companies' ability to specialize, and reducing their international competitiveness. African governments can act on three fronts to strengthen regional integration: (1) help corporate Africa to build scale by reducing the time it takes for goods to cross borders, continuing to lower tariffs between countries, and implementing double taxation agreements; (2) drive closer integration of regional capital markets to help attract FDI; and (3) encourage the movement of business people between African countries through simplified visa requirements.

5. **Create tomorrow's talent.** In several global surveys, Africa-based companies have reported major challenges in attracting and retaining the talent they need to run and grow their businesses. The challenge is heightened by the "brain drain": by one measure, more than 10 percent of Africa's highly educated professionals live and work on other continents.[24] Despite this, Africa faces a significant gap in post-secondary education and training options with approximately six million slots available each year for its 49 million annual high school graduates.[25] In vocational training, our analysis suggests that the continent would need to enroll approximately 33 million secondary school students per year in vocational programs by 2025, up from four million in 2012. Governments have a key role to play in ensuring that educational and training systems build these work-relevant skills, and that students are aware of, and encouraged to enter, these vocations. The private sector also needs to act, building on the skills development programs that several of Africa's most successful companies have put in place.

6. **Ensure healthy urbanization.** Africa's cities will be home to 190 million more people over the next decade. This rapid urbanization has the potential to bring significant economic benefits—provided governments prepare for it now. They need to improve planning processes, build more affordable housing, design and invest in efficient mass transit systems, increase access to electricity, and install more information and communication technology infrastructure.

Delivering on these six priorities will require a step change in the quality of Africa's public leadership and institutions. All these imperatives require the vision and determination to drive far-reaching reforms in many areas of public life—and a capable public administration with the skill and commitment to implement reforms. This will be particularly important as Africa moves to catch up with other regions in the strength of its business climate and its effectiveness in fighting corruption, measures in which it currently placed last in world rankings. Transforming public administration and governance does not have to be complex. Successful countries have put in place simple, quick, yet high-impact measures that have tackled challenges in operations, transparency, and compliance to remove business stresses and minimize opportunities for corruption—without requiring a systemic overhaul.

•••

The turbulence—both economic and political—in parts of Africa in recent years has doubtless been a shock, but it has not derailed the continent's growth story. The International Monetary Fund (IMF) still forecasts that Africa will be the second-fastest growing region in the world between 2016 and 2020 with annual growth of 4.3 percent. But what the past five years have proved is that Africa's diverse economies—its economic lions—now need to improve their fitness in order to make the most of their undoubted long-term growth potential and continue their march toward prosperity. The urgent imperative now is to accelerate investment and productivity, encourage continued economic diversification, make further improvements to Africa's business environment, nurture the continent's talent, and continue the process of regional integration.

[24] *World migration in figures*, OECD and UN Department of Economic and Social Affairs, October 2013.
[25] *State of education in Africa report 2015*, Africa-America Institute, 2015.

McKinsey Global Institute
September 2016
Copyright © McKinsey & Company
www.mckinsey.com/mgi

@McKinsey_MGI
McKinseyGlobalInstitute